



## 2009 ANNUAL REPORT

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## CORPORATE PROFILE

Our mission at Melcor is to be Alberta's premier real estate development and management company. We achieve this mission by continually striving to meet the needs of our customers, shareholders, fellow employees and business associates.

Melcor Developments Ltd. is engaged in the following activities:

### COMMUNITY DEVELOPMENT

- the acquisition, planning and development of urban communities and the subsequent marketing and sale of single family, multiple family and commercial/industrial lots in Alberta in the metropolitan areas of Calgary, Edmonton, Lethbridge, Red Deer and in the City of Kelowna, British Columbia and in the City of Regina, Saskatchewan.

### PROPERTY DEVELOPMENT

- the development of income producing properties in Western Canada.

### INVESTMENT PROPERTIES

- the ownership and management of income producing properties in Western Canada and the Southwestern USA.

### RECREATION PROPERTY

- the ownership and management of three championship golf courses in the Edmonton area and the Black Mountain golf course in Kelowna, British Columbia.

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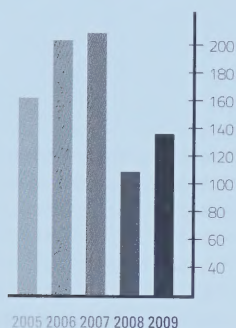
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## FINANCIAL HIGHLIGHTS

(\$)	2009	2008
Revenue	136,608,000	108,436,000
Earnings	23,224,000	41,021,000
Assets	708,203,000	707,982,000
Shareholder's equity	326,520,000	310,159,000
<b>PER SHARE</b>		
Basic earnings	0.78	1.32
Book value per share	10.78	10.42
Average share trading price	7.49	9.43
Dividends paid	0.25	0.42

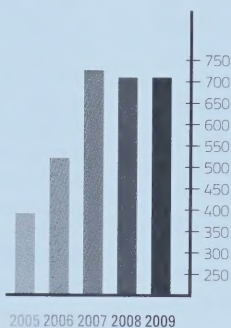
### REVENUE

(millions of dollars)



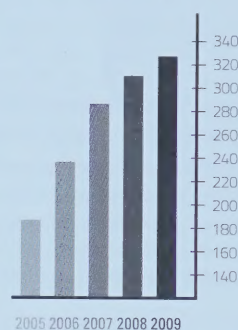
### ASSETS

(millions of dollars)



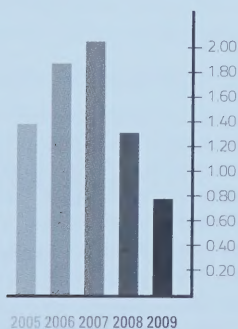
### SHAREHOLDER'S EQUITY

(millions of dollars)



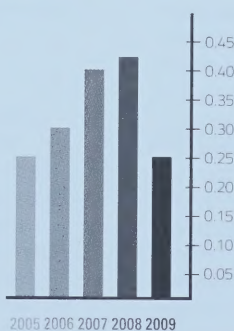
### EARNINGS PER SHARE

(dollars)



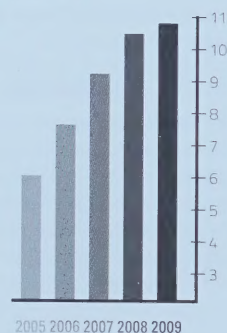
### DIVIDENDS PER SHARE

(dollars)



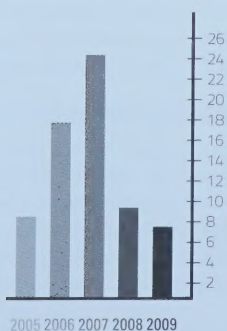
### BOOK VALUE PER SHARE

(dollars)



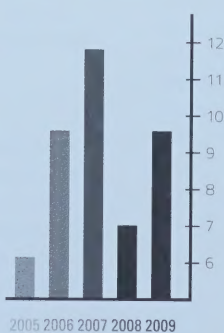
### AVERAGE SHARE PRICE

(dollars)



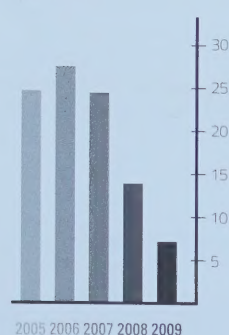
### PRICE EARNINGS RATIO

(dollars)



### RETURN ON EQUITY

(percent)







## MESSAGE FROM THE EXECUTIVE CHAIRMAN

On behalf of the Board of Directors, I am pleased to report that in 2009 net earnings were \$23,224,000 or \$0.78 per share compared to \$41,021,000 or \$1.32 per share in 2008. Although earnings were down in 2009 it should be noted that 2008 earnings included an extraordinary sale resulting in a gain of \$22,052,000 or approximately \$0.60 per share. Operating revenues and earnings in 2009 were higher than in 2008.

### PLANNING FOR CONTINUED SUCCESS

The Board of Directors have the responsibility of ensuring that the company has a business plan and budget in place that will optimize value for shareholders. This process involves consultation with management to discuss relevant issues including the general business environment, plan assumptions, appropriate levels of risk and review and approval of business goals and detailed financial budgets.

As mentioned in last years report, our Outlook for 2009 was one of caution and uncertainty. However, markets for serviced lots rebounded and the Company's Land Development Division exceeded our projections. The Investment Property Division also exceeded budget forecasts and increasingly contributes to earnings.

### DIVIDEND TO SHAREHOLDERS

The Board of Directors reduced the dividend to shareholders from \$0.42 per common share in 2008 to \$0.25 per common share for 2009. This was due to the lower level of earnings for the current year combined with the last year's climate of economic uncertainty which made it prudent to maintain adequate cash reserves.

### SUPPORT TO THE COMMUNITY

In the year 2009, Melcor continued its tradition of providing significant financial contributions and support to many charitable organizations, both in communities where we operate and to national causes. The Board of Directors is proud of the Company's financial commitment to these charitable organizations and also of the volunteer efforts of our employees in enhancing our community.

Of Particular mention was a pledge of one million dollars from Melcor and its senior management to the University of Alberta – School of Business. In keeping with our longstanding relationship with the esteemed School of Business, Melcor's 2010 Annual General Meeting will be held at the Faculty of Business on April 16th.

### OUTLOOK FOR 2010

In Alberta, the level of new home sales by builders and sale of serviced lots by land developers through 2009 was considerably greater than anticipated by the industry and as estimated in our Company forecast. Going into 2010, there is a sense that markets have stabilized. Home builders and other developers are cautiously optimistic. Should markets be stronger, Melcor is well positioned to respond and service additional lots to meet market demand. The Company's Property Development Division is also planning an active year of new developments. Assuming market trends continue we are cautiously forecasting that 2010 could be a year of modestly improved results for Melcor.

### ACKNOWLEDGEMENTS

The Board of Directors recognizes and expresses appreciation to management and staff for their continued outstanding contributions to the Company's success and growth. I also thank our Board of Directors for their guidance, our customers and suppliers for their business and support, and our shareholders for their continued confidence.

Executive Chairman, **Timothy C. Melton**



## MESSAGE FROM THE PRESIDENT AND CEO

I am pleased to report that 2009 produced very satisfactory results for our Company. While the first few months of 2009 experienced a continuation of the very difficult real estate and financial markets of the prior year, a relatively strong recovery began in the second quarter and continued through the year.

Melcor's share price reflected that change with a low of \$4.00 per common share in March 2009 recovering to \$11.39 per common share at the end the year. Revenues for the year were up significantly, and earnings were up moderately before the one time sale of an investment property in Regina. Revenues in the Community Development Division were up 35% while operating earnings were constant, reflecting price reductions in developed inventory and some adjustments of earnings related to amendments to agreements receivable and an option forfeited.

Melcor's management team was focused on achieving its business plan objectives, which included more aggressive marketing, preservation of asset values, improving its balance sheet, deferring growth initiatives and controlling costs. These initiatives were successful and led to lower margins, lower administration costs, a reduction in liabilities, improved cash flow and a reduced dividend to shareholders. All of these initiatives have improved our Company's ability to handle further economic uncertainty and to take advantage of improving opportunities to acquire real estate in depressed markets.

New acquisitions were curtailed in 2009, with a few exceptions, and management investigated opportunities to acquire residential assets in the Phoenix and Houston metropolitan areas.

### COMMUNITY DEVELOPMENT DIVISION

The Division had a successful year particularly in reducing inventories in the Edmonton Region and significantly exceeding its budgeted revenues. The Red Deer Region had strong sales and obtained a major annexation of Company lands to the City of Red Deer which will provide development lands for several decades. Sales activity in the Calgary Region was strong in Airdrie and significant approvals were obtained in west Calgary, north Calgary and the Balzac areas. The Lethbridge Region saw a stable business climate, and a further land acquisition was initiated to consolidate holdings in North West Lethbridge. In February 2009, the City of Regina annexed 686 acres of land in the NE quadrant of that City that are mainly planned for industrial development. Melcor's Black Mountain Community in Kelowna had a slow year with builders completing commitments purchased in 2008. The opening of Melcor's Black Mountain Golf Course is expected to improve lot sale activity in the area and show improved results in 2010.

### PROPERTY DEVELOPMENT DIVISION

The Division had another strong year with projects being completed and transferred to the Investment Property Division. New developments were initiated. Two Edmonton projects were completed including the Market at Magrath and Miller Commercial plus three properties in a phase in Chestermere. The Division has a significant flow of development projects in our Community Development Division pipeline in all regions of the Company's operations.

### INVESTMENT PROPERTY DIVISION

The Division grew its revenue and net operating earnings in excess of 10% in 2009 reflecting new asset growth and continuing improvement in tenant rental rates on renewals. Growth in market rental rates flattened in the latter half of the year and are expected to remain flat in 2010. Revenue growth will come from the addition of assets transferred from the Property Development Division and from those existing leases being renewed at current market rates over the lower rates that were in place prior to renewal. The Division has successfully integrated its Phoenix residential property and is looking to expand in the Phoenix and Houston markets.

### RECREATION PROPERTY DIVISION

The Division now has interests in four operating golf course properties in the Edmonton Region and in Kelowna. The opening of Black Mountain Golf Course in Kelowna has met with good customer response. The Division operating results are expected to improve significantly in 2010 with a full year of revenue at the Black Mountain Golf Course which has recently been nominated by Score magazine as one of the best new golf courses in Canada for 2010.

### MANAGING FOR SUCCESS

The Company recognizes that its dedicated, professional and motivated staff and management team are the important ingredients to the success of the Company and its shareholders. The management team is looking at continuing to improve the skills and depth of talent to take the Company into the future. We expect to see growth and change in the team, as we position ourselves for future success.

### 2010 OUTLOOK

The management team has planned for an improved year in 2010, although we anticipate continued volatility in real estate and financial markets. We have enjoyed unprecedented low interest rates, which have provided strength in residential markets and high valuations of real estate assets as investment yields have remained low. In the event that interest rates increase significantly, it could have a negative effect on real estate markets.

Management also expects that the Alberta economy will see improvement in 2010 with improving energy pricing, reinvestment in energy related capital projects, job creation and in-migration to the Province. Management remains optimistic about the mid term opportunities in some US markets as they recover from unprecedented economic distress. Management remains confident that it has the necessary resources, together with a strong financial base and strong business relationships to have a satisfactory year in 2010.

President and Chief Executive Officer, **Ralph B. Young**





## MESSAGE FROM VICE PRESIDENT FINANCE & CFO

Fiscal 2009 was Melcor's fifth best year in terms of earnings and is the fourth best based on operations (factoring out the large non-operating gain that was realized in 2008). The recession that was looming a year ago, has technically passed. The current levels of activity seem to have adjusted to historical levels. We believe that the basic fundamentals of a strong economy in Alberta, will continue to have a positive affect on the real estate industry. Low interest rates are a significant factor in stabilizing the real estate market.

The Performance Chart on page 30 of this annual report illustrates Melcor's five-year cumulative total shareholder return, assuming an initial investment of \$100 with all dividends reinvested versus the return on the TSX 300 Composite Index and the TSX Capped Real Estate Index. Over the past 5 years, the investment in Melcor has grown to \$256 compared to the S&P / TSX Composite Index growth of \$145 and the TSX Capped Real Estate Index which is at \$122. Melcor continues to outperform the comparable indexes.

The Company continues to have a strong relationship with its major lenders. At December 31, 2009, our debt to equity ratio was 1.10 to 1 compared to 1.28 to 1 in the prior year. This is below the Company's acceptable debt to equity level of 2.0 to 1 which is conservative given that it is based on historical cost versus the fair value of the Company's assets. The Company's ability to service its debt continues to be strong. However, the credit markets are still tight as lenders lack the confidence to lend under the same terms and conditions that they had previously been lending at. The short term cash flow pressures that were present a year ago, have been relieved as the Company collected its agreements receivable that had been extended and brought down the inventory of lots to a desired level.

Assets decreased by 3.1% and shareholder equity grew by 5.3%. Both return on equity and return on assets (see performance measures at the back of the annual report) were below their respective five year averages. Debt (bank operating line plus land inventory loans and investment property mortgages) has decreased by \$8.7 million during the year. The bank operating loan uses agreements receivable and land under development as security. At the year end, the bank operating loan leverage ratio was 39.7% of the assets financed (with lot inventory at cost as opposed to its selling value) compared to 36.2% in the prior year. Debt on land held for future development decreased by \$14.1 million while land held for future development grew by \$4.1 million. Debt on

investment properties grew by \$16.7 million while the assets increased by \$16.5 million resulting in a leverage ratio of 91.7% at the year end compared to 90.9% in the prior year. The book value per share grew by 3.5% from \$10.42 per common share to \$10.78 per common share after paying dividends totaling \$0.25 per common share.

Credit markets for long term fixed rate financing were tight in the first half of 2009 but began correcting by mid year as the international credit markets began to stabilize. On a typical property, we have found that lenders have been decreasing their spreads from a high of 375bps on a 5 year term to a current level of about 225bps which is still about 50bps higher what we have experienced in "normal" times. While rates have stabilized somewhat, loan amounts are still below desired levels. Loan to value ratios will be as low as 50% for some lenders as they are factoring in debt coverage premiums on the premise that interest rates will be much higher in the future when the term of the loan is over. This change will impact the amount of borrowing that the company will achieve relative to borrowing practices over the past years. During the year, the Company was successful in raising \$5.0 million from 1 variable rate mortgage and \$32.8 million (net of joint venture interests) from 3 fixed rate mortgages generating \$20.4 million net cash after repayment of existing mortgages. These loans had a weighted average of 5.53% which is below our average fixed rate borrowing cost for the Company.

The annual meeting will be held on April 16, 2010 at 11:00 am at the University of Alberta, Business Building (Stollery Executive Development Centre) Room 504, 5th Floor, 11211 Saskatchewan Drive Edmonton, Alberta, Canada. We would invite all shareholders and interested parties to review this annual report and related proxy materials.

*Michael Shabada*

Vice President Finance & CFO, **Michael D. Shabada**

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# MANAGEMENT'S DISCUSSION AND ANALYSIS ("MD&A")

**MARCH 3, 2010**

The following discussion and analysis of the financial results and position of Melcor Developments Ltd. should be read in conjunction with the audited financial statements and notes to those statements for the years ending December 31, 2009 and 2008. The financial data provided has been prepared in accordance with Canadian Generally Accepted Accounting Principles. The Company's reporting currency is Canadian dollars. Certain statements in this discussion can be considered forward looking, and readers are cautioned that such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those contained in these forward looking statements. These risks and uncertainties are described elsewhere in this discussion and in other regulatory filings.

Additional information including the Annual Information Form and Management Information Circular is available from SEDAR at [www.sedar.com](http://www.sedar.com).

The balance sheet is presented without reference to current assets or current liabilities. The operating cycle of an entity involved in real estate investment and development is normally considered to be longer than one year. Thus, the concept of current assets and current liabilities is not considered relevant and there is no need to segregate the balance sheet to disclose assets or liabilities which are expected to be settled within the immediately following year.

## BASIC ACTIVITIES

Melcor Developments Ltd. ("Melcor" or "the Company"), which traces its history back to 1923, has been a public company since 1968 and trades under the symbol "MRD" on the Toronto Stock Exchange. It has operated and prospered for over 86 years, due to stable and committed ownership and loyal and dedicated staff who are focused on the real estate industry. Melcor primarily operates in Alberta in the metropolitan areas of Calgary, Edmonton, Lethbridge and Red Deer. It also has assets in Kelowna (British Columbia), Regina (Saskatchewan) and Phoenix (Arizona). Its diversified operations include:

- the acquisition of raw land, which is held for future development until market conditions warrant the planning, servicing and marketing of urban communities which are then sold in the form of single family, multiple family and commercial / industrial lots;
- the development of income producing properties in Alberta;
- the ownership and management of income producing properties in Western Canada; and
- the ownership and management of championship golf courses in Western Canada.

## MISSION STATEMENT

Melcor's mission is to be Alberta's premier real estate development and management Company by successfully meeting the needs of our:

- Shareholders, partners and lenders;
- Customers and suppliers;
- Selves and fellow employees; and
- Communities.

## OVERALL PERFORMANCE

### RESULTS OF OPERATIONS

Net earnings for the year were \$23,224,000 compared to prior year earnings of \$41,021,000. Basic earnings per share for 2009 were \$0.78, a 41% decrease from 2008 earnings per share of \$1.32.

Current year operating results were a significant improvement from the prior year as revenues were \$136,608,000 versus \$108,436,000 in 2008 and earnings before income taxes and gains on sale were \$30,457,000 versus \$28,373,000 in the prior year. Margins were down in the Community Development Division as discounts were used to reduce the Company's oversupply of inventory that was held at the start of the year. The Investment Property Division has continued to produce strong returns, with increased earnings from operations in the current year.

	YEAR ENDED		THREE MONTHS ENDED	
Financial Highlights (\$)	Dec. 31, 2009	Dec. 31, 2008	Dec. 31, 2009	Dec. 31, 2008
Revenue	136,608,000	108,436,000	48,872,000	41,758,000
Earnings	23,224,000	41,021,000	9,918,000	14,404,000
Assets	708,203,000	707,982,000	708,203,000	707,982,000
Shareholders' equity	326,520,000	310,159,000	326,520,000	310,159,000
<b>PER SHARE</b>				
Basic earnings	0.78	1.32	0.33	0.47
Diluted earnings	0.77	1.31	0.33	0.47
Book value <sup>1</sup>	10.78	10.42	10.78	10.42

<sup>1</sup> See "Non-GAAP Financial Measures" section



## SUMMARY OF QUARTERLY RESULTS

Financial information for the prior eight fiscal quarters is as follows:

	REVENUES	NET EARNINGS	EARNINGS PER COMMON SHARE	
	(\$000s)	(\$000s)	Basic (\$)	Diluted (\$)
March 31, 2008	20,932	4,373	.14	.14
June 30, 2008	19,779	3,702	.12	.12
September 30, 2008	25,967	18,542	.59	.58
December 31, 2008	41,758	14,404	.47	.47
March 31, 2009	16,083	183	.01	.01
June 30, 2009	27,279	3,746	.12	.12
September 30, 2009	44,374	9,377	.32	.31
December 31, 2009	48,872	9,918	.33	.33

Earnings will fluctuate from one quarter to another due to the timing of plan registrations and the cyclical nature of the real estate markets.

## SELECTED ANNUAL INFORMATION

(\$000s)	2009	2008	2007	2006	2005
Revenue	<b>136,608</b>	108,436	207,024	203,402	161,500
Earnings	<b>23,224</b>	41,021	63,670	57,771	41,776
Assets	<b>708,203</b>	707,982	726,765	522,927	396,113
Liabilities	<b>381,683</b>	397,823	440,281	287,017	209,785
Equity	<b>326,520</b>	310,159	286,484	235,910	186,328
(\$)					
Basic earnings per share	<b>0.78</b>	1.32	2.05	1.87	1.38
Diluted earnings per share	<b>0.77</b>	1.31	2.00	1.83	1.35
Dividends per share	<b>0.25</b>	0.42	0.40	0.30	0.25

## CORPORATE RISK

The cyclical nature of the Company's business along with 84% of its assets being located in Alberta, may subject Melcor to greater risks than companies that are more geographically diversified. Various factors which are not in management's control can impact the Company's business. These factors include:

- interest and inflation rates;
- general economic conditions in the regions in which the Company operates;
- population growth and migration;
- job creation and employment patterns;
- consumer confidence;
- pricing of input costs;
- competitor's strategies;
- government policies, regulations and taxation; and
- availability of financing for real estate assets.

## COMMUNITY DEVELOPMENT OPERATIONS

The Community Development Division is responsible for the acquisition, planning, development and marketing of urban communities. Although the Division predominantly develops mixed-use residential communities, it also develops large-scale commercial and industrial centres in the Edmonton, Red Deer and Calgary regions. The majority of residential lots and parcels are sold to selected homebuilders that purchase sites through agreements for sale.

Strategic initiatives for 2010 – 2012 include:

- Maintain or increase market share in current markets;
- Increase revenue and margins over 2009;
- Continue tight cash management through continuing fragile economy;
- Tight inventory control through continuing fragile economy;
- Consider acquisitions in Canada which are complimentary to existing land holdings;
- Consider selective selling of some non-core land assets;
- Start development on new project in west Calgary; and
- Continue with significant planning approvals in:
  - Recently annexed lands in west Calgary;
  - Sylvan Lake, Alberta land holdings; and
  - Future development lands in south west Edmonton.

## ANNUAL OPERATING REVIEW

(\$000s)	2009	2008	2007	2006	2005
Revenue	<b>91,839</b>	72,401	182,941	183,581	149,246
Cost of sales	<b>(56,269)</b>	(37,583)	(84,316)	(103,653)	(79,723)
Allowance adjustments	<b>(1,060)</b>	(1,200)	-	-	-
Option deposit forfeited	<b>(709)</b>	-	-	-	-
Net operating income (NOI) <sup>1</sup>	<b>33,801</b>	33,618	98,625	79,928	69,523
Interest revenue	<b>1,719</b>	5,015	6,557	4,109	1,449
Interest expense	<b>(831)</b>	(1,291)	(726)	(935)	(468)
	<b>34,689</b>	37,342	104,456	83,102	70,504
Administrative expenses	<b>(4,587)</b>	(4,675)	(5,653)	(4,472)	(3,938)
Divisional earnings	<b>30,102</b>	32,667	98,803	78,630	66,566

<sup>1</sup> See "Non-GAAP Financial Measures" section

## QUARTERLY OPERATING REVIEW

(\$000s)	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Total 2009
Revenue	6,968	16,001	31,151	37,719	<b>91,839</b>
Cost of sales	(3,895)	(10,333)	(20,035)	(22,006)	<b>(56,269)</b>
Allowance adjustments	(760)	-	-	(300)	<b>(1,060)</b>
Option deposit forfeited	(709)	-	-	-	<b>(709)</b>
Net operating income (NOI) <sup>1</sup>	1,604	5,668	11,116	15,413	<b>33,801</b>
Interest revenue	346	619	616	138	<b>1,719</b>
Interest expense	(220)	(217)	(200)	(194)	<b>(831)</b>
	1,730	6,070	11,532	15,357	<b>34,689</b>
Administrative expenses	(1,043)	(1,094)	(1,057)	(1,393)	<b>(4,587)</b>
Divisional earnings	687	4,976	10,475	13,964	<b>30,102</b>

<sup>1</sup> See "Non-GAAP Financial Measures" section



## SELECTED FINANCIAL BENCHMARKS

(\$000s)	2009	2008	2007	2006	2005
<b>ASSETS</b>					
Agreements receivable	<b>81,316</b>	90,056	140,625	127,178	85,335
Land inventory	<b>413,667</b>	424,668	384,974	255,570	201,398
	<b>494,983</b>	514,724	525,599	382,748	286,733
<b>DEBT</b>					
Bank debt	<b>68,026</b>	79,502	85,629	29,599	16,026
Provision for land development costs	<b>43,154</b>	35,725	51,103	39,805	29,026
Debt on land inventory	<b>65,556</b>	79,688	106,565	72,440	50,478
	<b>176,736</b>	194,915	243,297	141,844	95,530
Net investment	<b>318,247</b>	319,809	282,302	240,904	191,203
NOI as % of revenue <sup>1</sup>	<b>36.8%</b>	46.4%	53.9%	43.5%	46.6%
Divisional earnings as % of net investment <sup>1</sup>	<b>9.4%</b>	10.9%	37.8%	36.4%	40.5%
% of assets financed <sup>1</sup>	<b>35.7%</b>	37.9%	46.3%	37.1%	33.3%

<sup>1</sup> See "Calculations" in "Non GAAP Financial Measures" section

## SALES ACTIVITY & REGIONAL HIGHLIGHTS

### a) Sales Activity

Total sales for the Division were \$91,839,000 in 2009 versus \$72,401,000 in the prior year. This increase is due partly to the extraordinary weakness of the market in 2008 and a somewhat unexpected surge in activity in 2009.

While markets will show some improvement over 2009 in all regions they will continue to be at levels well below the trailing 5 year average. During 2009 the Division was successful in bringing its inventory of serviced lots down to a healthy level in terms of price and quantity. Although new phases of development are planned for all regions in 2010, inventories will be kept at or near current levels through the 2010 fiscal year.

Shareholders are reminded that earnings can fluctuate significantly from one year to another due to the timing of plan registrations, the cyclical nature of real estate markets and the mix of lot sizes and product types and the mix of joint venture sales activity.

Plan registrations are key to revenue recognition in the real estate development industry. This process creates the legal title to the product we are selling (i.e. Lot, Block, Plan) and it also defines the exact dimensions of the lot. In order to sell real property, it must have a legal title. As for timing of registrations, usually more registrations occur in the fourth quarter over any of the other three quarters. This is primarily due to the time it takes from when construction can commence (based on weather and frozen ground conditions), to the time it takes the municipalities to grant development agreements, after which plan registration can occur, usually in the fourth quarter.

In many instances, plan registration is often the last revenue recognition criteria to be met before a sale can be recorded. Builders are often aware of the product and are lined up for the purchase of inventory and as such, once plan registration occurs, sales are often immediate. Therefore, because many plan registrations occur in the fourth quarter, the majority of sales also occur in the fourth quarter.

The timing also coincides with builder inventory levels. Builders' revenues are greatest during the first half of the year when they are selling to the home owners. The majority of builders tend to work through their inventory over the summer months building and selling homes. Come the fall, their inventory levels are also low, and as such they tend to stock up over the winter.

The current cycle of reduced demand is expected to last well into 2010 with some improvement later in the year and in 2011. The Division expects 2010 pricing to be similar to the latter part of 2009. Continued surplus construction capacity will help to keep development costs down resulting in some improvement to margins over 2009. Depending on future supply and demand for labor, cost of fuel, etc., servicing costs will decrease as market pricing adjusts for the slower economic demands.

**REVENUE ANALYSIS (\$)**

	Twelve Months Ended December 31, 2009			Twelve Months Ended December 31, 2008		
	External Revenue (1)	Units/Acres @ 100% (2)	Gross Average Revenue Per Unit/Acre (3)	External Revenue (1)	Units/Acres @ 100% (2)	Gross Average Revenue Per Unit/Acre (3)
Single family lots	84,340,000	824	125,700	57,086,000	577	138,800
Multiple family sites	5,053,000	6.1	831,100	7,026,000	6.9	1,022,800
Commercial sites	-	-	-	-	-	-
Industrial parcels	-	-	-	1,758,000	1.9	950,000
Non-strategic parcels	127,000	3.1	53,600	-	-	-
Other land	1,175,000	122.2	19,200	828,000	11.0	112,400
Management fees & other	1,077,000			1,398,000		
	91,772,000			68,096,000		

(1) External Revenue excludes inter-Divisional sales. (See Segmented Information note to Consolidated Financial Statements).

(2) Units/Acres are not prorated for joint venture interests.

(3) Gross average revenue per unit/acre is based on the inclusion of the joint venture participant's interests in both revenue and in the unit/acre sold.

**REGIONAL SALES ANALYSIS - TWELVE MONTHS ENDED DECEMBER 31, 2009**

(including joint ventures at 100%)	(Lots)	(Acres)			
	Single Family	Multi- Family	Commercial	Industrial	Raw Land
Edmonton	488	6.1	-	-	2.0
Calgary	105	-	-	-	-
Red Deer	151	-	-	-	123.3
Lethbridge	77	-	-	-	-
Kelowna	3	-	-	-	-
	824	6.1	-	-	125.3

**REGIONAL SALES ANALYSIS - TWELVE MONTHS ENDED DECEMBER 31, 2008**

(including joint ventures at 100%)	(Lots)	(Acres)			
	Single Family	Multi- Family	Commercial	Industrial	Raw Land
Edmonton	90	6.9	-	-	1.2
Calgary	52	-	-	1.9	3.6
Red Deer	334	-	-	-	1.1
Lethbridge	81	-	-	-	5.1
Kelowna	20	-	-	-	-
	577	6.9	-	1.9	11.0

**RESIDENTIAL LOT SALE HISTORY**

(including joint ventures at 100%)	2009	2008	2007	2006	2005
Edmonton	488	90	526	844	811
Calgary	105	52	270	310	260
Red Deer	151	334	396	466	520
Lethbridge	77	81	128	140	85
Kelowna	3	20	29	15	-
	824	577	1,349	1,775	1,676



**b) Edmonton Region**

The Company has active developments in the Cities of Spruce Grove, Leduc and St. Albert as well as the south west, south east and west end of Edmonton. The Region showed an increase in lot sales of over 400% over 2008. The primary reason for this increase was a stronger than expected local economy coupled with an aggressive inventory reduction program.

**c) Calgary Region**

The Company is currently developing projects in both the Town of Chestermere and the City of Airdrie, where most of the region's revenue has been realized in the past few years. Total lot sales doubled in 2009 in this region. In 2010 development will start on the Division's west Calgary annexation lands marking the end of a 7 year absence for the Division of residential development within the City of Calgary.

**d) Red Deer Region**

The Company was active in both the Southbrook community in the south east part of the City of Red Deer and in the Clearview community in the north east. The Region had lot sales of 151 compared to 2008 of 334. This was the result of large lot inventories carried by builders and a slow down that hit Red Deer later than the other regions. During the year, 815 acres of lands owned by the Company were annexed to the City of Red Deer.

**e) Lethbridge Region**

The Company continues to be active in the north part of the City of Lethbridge in the Legacy Ridge community and in the south part of Lethbridge in the community of Paradise Canyon. The Region recorded 77 lot sales during the year, compared to 81 in 2008.

**f) Kelowna Region**

The Company continued with development and sales in its Black Mountain residential community. During the 2009 year, only 3 single family residential lots were sold within the development. The clubhouse at the Black Mountain golf course opened in June of 2009. The opening of this golf course was well received by the public and is generating traffic into the community.

During the current year, the Division purchased 52 acres (including joint venture interest at 100%) of land in the Kelowna region. This land is strategically adjacent to other long term land holdings of the Division.

**g) Regina Region**

In 2009, 686 acres of future industrial land were annexed into the City of Regina. Preliminary planning on these lands is currently underway.

**h) Summary**

Housing markets in all regions appear to be firming up and providing a base for modest growth in 2010 and 2011. Revenues and earnings in 2010 are expected to improve over 2009. Net operating income as a percentage of revenue, was 36.8% which is below levels achieved during 2005 – 2008. However, it is just below the long term historical level of 40%. Management expect margins to rise to the long term historical level over the next year or two.

*INVENTORY***DEVELOPED INVENTORY CARRY FORWARD SCHEDULE****RESIDENTIAL LOT SALE INVENTORY**

(including joint ventures at 100%)	2009	2008	2007	2006	2005
At beginning of the year	1,112	875	593	612	779
New developments	273	814	1,631	1,756	1,509
Sales	(824)	(577)	(1,349)	(1,775)	(1,676)
	561	1,112	875	593	612

**MULTI-FAMILY/COMMERCIAL/INDUSTRIAL SITE INVENTORY**

(in acres - including joint ventures at 100%)	2009	2008	2007	2006	2005
At beginning of the year	161	148	127	160	92
New developments	9	27	61	76	122
External sales	(6)	(5)	(31)	(99)	(33)
Internal transfers	-	(9)	(9)	(10)	(21)
	164	161	148	127	160

# UNDEVELOPED INVENTORY CARRY FORWARD SCHEDULE

## LAND INVENTORY

(in acres – net of joint venture interests)	2009	2008	2007	2006	2005
At beginning of the year	8,808	8,865	7,092	6,117	6,159
Purchases	26	86	2,135	1,305	993
Sales	(63)	-	-	(56)	(426)
Developed	(56)	(143)	(362)	(274)	(609)
	8,715	8,808	8,865	7,092	6,117
Average cost per acre (\$)	28,100	27,800	27,600	22,800	20,200

The acquisition of land inventory is based upon management's anticipation of market demand and development potential. The average cost per acre has increased in each of the past five years. Land purchases during the last five years are as follows:

## LAND PURCHASES

(in acres – net of joint venture interests)	2009	2008	2007	2006	2005
Edmonton	-	-	327	379	353
Calgary	-	3	491	132	16
Red Deer	-	17	471	704	45
Lethbridge	-	-	160	85	203
British Columbia	26	66	-	5	376
Regina	-	-	686	-	-
	26	86	2,135	1,305	993
(\$000s)					
Land cost	700	2,240	89,633	55,349	29,774
Vendor financing	(275)	(878)	(51,137)	(29,872)	(13,035)
Net cash used for acquisitions	425	1,362	38,496	25,477	16,739



## LAND HOLDINGS

Land Inventory by Region	Developed Inventory (Including Joint Ventures at 100%)		Undeveloped Inventory (Net of Joint Venture Interests)	
	Residential Lots	Residential Acres	Commercial / Industrial Acres	Acres
<b>NORTHERN ALBERTA</b>				
Edmonton	111	9	-	1,124
Spruce Grove	113	3	14	931
County of Parkland	-	-	-	571
Leduc	127	3	7	389
St. Albert	13	-	-	85
<b>SOUTHERN ALBERTA</b>				
Calgary	-	-	7	835
Airdrie	1	5	46	665
M.D. Rockyview	-	-	-	849
Chestermere	58	-	21	41
Lethbridge	63	-	-	575
<b>CENTRAL ALBERTA</b>				
Red Deer	22	5	-	938
County of Red Deer	-	-	-	204
Sylvan Lake	-	-	-	220
Innisfail	-	-	-	129
<b>BRITISH COLUMBIA</b>				
Kelowna	53	44	-	407
Fraser - Fort George	-	-	-	66
<b>SASKATCHEWAN</b>				
Regina	-	-	-	686
<b>DECEMBER 31, 2009</b>	<b>561</b>	<b>69</b>	<b>95</b>	<b>8,715</b>
DECEMBER 31, 2008	1,112	66	95	8,808

Undeveloped land inventory is an aggregate of raw land and unregistered projects and their related pre-development costs. Pre-development costs include the cost of regulatory approvals, planning, engineering and infrastructure servicing. The latter can be significant in instances where utilities or roadways are constructed over expanses of raw land in order to bring services or access to subdivisions that are being developed.

### FINANCING

The Division attempts to finance its land acquisition activities by obtaining vendor financing on a portion of the acquisition price. Please see the "Financial Instruments" section of this MD&A for further information.

The Division may also access a credit facility which, on a margined basis, allows for the borrowing of money using agreements receivable, developed land inventory and undeveloped land inventory as collateral. Please see the "Liquidity" section of this MD&A for further information.

### RISK FACTORS

Residential lot sales are influenced by the demand for new housing which is impacted by interest rates, growth in employment, in-migration, new family formations and the size of these families. Our ability to bring new communities to the market is impacted by municipal regulatory requirements and environmental considerations which affect the planning, subdivision and use of land. The lengthy planning and approval process can take up to eighteen months. During this period, the market conditions in general and / or the market for lots in the size and price range in our developments may change.

The Company must manage its financial resources to ensure that it has adequate financial and operational cash flow to support the holding cost of its inventory and land holdings.

Management attempts to mitigate these risks by:

- Developing in the vicinity of major population and employment centres in Alberta where we have developed land for decades;
- Making the strategic acquisition of land for future development a priority;
- Marketing lots in various sizes and price ranges in all regions in which we carry on development programs;
- Monitoring market conditions by maintaining close contact with our customers, industry associations and forecasting agencies;

## RISK FACTORS CONTINUED

- Managing and participating in joint ventures;
- Contracting highly regarded professional consultants as required rather than having them on staff; and
- Practicing an environmental program to minimize risk on acquisitions and development.

## PROPERTY DEVELOPMENT OPERATIONS

The Property Development Division acquires commercial sites from the Community Development Division at fair market value with the goal of creating additional value by developing the sites into revenue producing properties. Once completed, these assets are transferred at fair market value to the Investment Property Division, with a mandate to hold and manage the assets. The profit earned on transfer is eliminated upon consolidation.

Strategic initiatives for 2010 - 2012 include:

- To implement the Business Plan for the Division and to meet the Corporate objectives of asset diversification, income growth and stability by constructing revenue producing developments primarily on land created through the Company's land development operations in Alberta;
- To oversee construction and leasing on up to 30,000 square feet of retail space in Airdrie;
- To advance the remaining construction and leasing of 15,000 square feet of retail space in Miller Crossing, a neighborhood shopping centre in north east Edmonton;
- To continue the development of Leduc Common in Leduc, Alberta; and
- To advance projects in Spruce Grove, Red Deer, Calgary and Lethbridge on lands currently transferable from the Community Development Division.

## ANNUAL OPERATING REVIEW

(\$000s)	2009	2008	2007	2006	2005
Revenue	<b>36,825</b>	62,615	8,112	13,638	9,392
Cost of sales	<b>(25,363)</b>	(38,259)	(6,165)	(11,531)	(6,950)
Net operating income (NOI) <sup>1</sup>	<b>11,462</b>	24,356	1,947	2,107	2,442
Administrative expenses	<b>(750)</b>	(774)	(570)	(518)	(349)
Divisional earnings	<b>10,712</b>	23,582	1,377	1,589	2,093

<sup>1</sup> See "Non-GAAP Financial Measures" section

## QUARTERLY OPERATING REVIEW

(\$000s)	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Total 2009
Revenue	18	31,250	836	4,721	<b>36,825</b>
Cost of sales	-	(20,723)	(679)	(3,961)	<b>(25,363)</b>
Net operating income (NOI) <sup>1</sup>	18	10,527	157	760	<b>11,462</b>
Administrative expenses	(152)	(236)	(179)	(183)	<b>(750)</b>
Divisional earnings	(134)	10,291	(22)	577	<b>10,712</b>

<sup>1</sup> See "Non-GAAP Financial Measures" section

## DEVELOPMENT ACTIVITY

### LEDUC COMMON - Leduc, Alberta

Over the past three years, the Division has been working on the development of Phase 3 of this 500,000 sq. ft. regional power centre. To date Phase 3 has yielded the construction and lease up of a 26,000 sq. ft. retail building and three pad sites including a 7,400 sq. ft. pad to a Chartered Bank which is expected to be completed and generating revenue early in the second quarter of 2010. In addition, the last pad site in Phase 1 was built into a 5,800 sq. ft. retail building which is leased and will be generating revenue during the second quarter of 2010. Phase 3 has room for a 20,000 square foot multi-tenant commercial retail unit ("CRU") which could commence construction in 2010 pending pre-leasing activity. The Division has two additional phases scheduled for Leduc Common, which are expected to be developed over the next five years. Market demand for this project remains strong as evidenced by zero vacancy in the entirety of Leduc Common.

### CHESTERMERE STATION - Chestermere, Alberta

During 2009, the construction and lease up of Phase IV began and three buildings were completed and transferred to the Investment Property Division. A fourth building is pending municipal approval and will be built this year, thus completing the phase. In addition, 2010 construction will include a 1,800 sq. ft. national fast food restaurant and 3,600 sq. ft. retail building which will complete Phase II of the development and is expected to generate revenue for the fourth quarter of this year. The Division is now focused on the planning stages of Phase V which will see the development of the Town of Chestermere's "Main Street" which is an extension of the overall commercial development and will link the existing Town Hall with the retail lands. This phase of development includes a minimum of two pad sites, a 40,000 sq. ft. office/retail multi-tenant building and a conventional multi-tenant CRU building. Interest in Chestermere Station remains strong.



### **WESTGROVE COMMON - Spruce Grove, Alberta**

Westgrove Common is a large retail centre that is shadow anchored by Home Depot and Real Canadian Superstore. The Division has constructed 2 buildings totaling 6,738 sq. ft. in previous years. During 2010 a 6,321 sq. ft. chartered bank will open in the third quarter of 2010. Future development of 23,000 sq. ft. of retail space will complete the current phase. Additional commercial sites adjacent to the Westgrove Common could be developed in 2 – 5 years.

### **MARKET at MAGRATH - Edmonton, Alberta**

The Market at Magrath includes 3 pad sites which were completed in 2007 and a 65,000 sq. ft. office building with main floor retail which was completed in 2009. All but about 5,200 sq. ft. of office space has been leased. This project remains one of the most successful projects undertaken by the Division.

### **MILLER COMMERCIAL - Edmonton, Alberta**

This 3.3 acre neighbourhood centre includes a 11,750 sq. ft. Rexall Drug Store which was completed in 2009 and the expected completion in 2010 of a 11,500 sq. ft. CRU and a 4,200 multi-bay outparcel.

### **KINGSVIEW MARKET - Airdrie, Alberta**

The Division has commenced development of a 35 acre regional shopping centre known as Kingsview Market, which will be home to an assortment of national and regional retailers. During 2010, construction will commence on three buildings totaling approximately 35,000 sq. ft., most of which has been successfully pre-leased.

### **FUTURE PROJECT UPDATE**

The Division has projects that will receive significant planning activity during the year including:

- Red Deer (Regional Shopping Centre, commencement 2011);
- Edmonton (Ellerslie Business Park, Regional Office Park, commencement 2011);
- Calgary (Country Hills Crossing, Regional Office/Industrial Park, commencement 2011);
- Calgary (Sweet Lands, Regional Power Centre, commencement in 2013); and
- Lethbridge (Denecky Commercial, Regional Power Centre, commencement 2013).

### **SALES ACTIVITY**

Sales activities for the Division are generated from the transfer of revenue producing assets to the Investment Property Division. The Division also earns management fees from managing the development of properties within joint ventures.

During the year, the Division completed construction of the Magrath Business Centre which was transferred to the Investment Property Division during the third quarter of 2009.

In Chestermere Station, the Division completed construction of three separate buildings totaling 25,000 sq. ft. of retail space (including joint venture interest at 100%). All three buildings are national tenancies and were transferred to the Investment Property Division during the second and third quarters.

### **FINANCING**

The Division funds its operations through interim financing from financial institutions or from internal sources. Historically, the Division has been successful in obtaining very competitive long-term fixed rate financing terms by waiting until the asset has been built and substantially leased. Typically, the Division obtains takeout financing on behalf of the Investment Property Division. As at December 31, 2009, there was no specific debt in the Division.

### **RISK FACTORS**

The major risks include:

- Leasing risks (finding qualified tenants to lease the completed space);
- Construction risks (managing the cost and quality of developing the project); and
- Financing risks (ensuring the project has adequate financing resources).

Management attempts to mitigate these risks by:

- developing in the vicinity of major population and employment centres where the Company conducts business and owns similar assets;
- hiring professional consulting firms to aid in the planning and design of the project;
- using professional consultants and realtors to market the new projects;
- analysing market conditions and evaluating potential customers;
- obtaining adequate pre-leasing levels prior to construction;
- acquiring the land after the project is approved (i.e. sites are not inventoried);
- contracting with reputable construction companies that use fixed / target price contracts;
- constantly monitoring leasing activity, construction progress and project costs; and
- communicating with financial institutions regarding interim and take-out financing.

## INVESTMENT PROPERTY OPERATIONS

The Investment Property Division has established itself as a key contributor to the continuing success of Melcor as one of Alberta's premier real estate development companies. The majority of the Division's assets are managed by the Company with third party property management used for properties outside the Edmonton Region.

Strategic initiatives for 2010 – 2012 include:

- To implement the Business Plan for the Division to meet objectives of increasing the return on investment;
- To focus on client retention through continuous customer contact and ongoing service evaluation;
- To reorganize the Division to manage future growth and to implement a management succession plan for the Division;
- To acquire multi-family revenue producing assets in Arizona and Texas;
- To enhance the quality of the portfolio's assets by upgrading their appearance, functionality and desirability thereby increasing their rental opportunity;
- To obtain and maintain financing to ensure reasonable leverage of its assets;
- To execute detailed leasing strategies for each asset; and
- To maintain occupancy levels above 90% over the next 3 years.

## ANNUAL OPERATING REVIEW

(\$000s)	2009	2008	2007	2006	2005
Rental revenue	<b>39,443</b>	36,510	25,771	19,765	15,749
Operating expenses	<b>(16,081)</b>	(15,729)	(11,159)	(8,805)	(7,273)
Net operating income (NOI) <sup>1</sup>	<b>23,362</b>	20,781	14,612	10,960	8,476
Interest income	<b>15</b>	51	33	36	22
Interest expense	<b>(7,773)</b>	(6,874)	(4,699)	(3,811)	(2,914)
Amortization of investment properties	<b>(4,385)</b>	(4,038)	(2,959)	(2,303)	(1,709)
Amortization of tenant leasing costs	<b>(2,578)</b>	(2,382)	(1,705)	(1,456)	(1,145)
Administrative expenses	<b>(1,118)</b>	(794)	(758)	(535)	(451)
Earnings from operations	<b>7,523</b>	6,744	4,524	2,891	2,279
Gain on sale of investment property	<b>339</b>	22,052	-	11,108	-
Divisional earnings	<b>7,862</b>	28,796	4,524	13,999	2,279

<sup>1</sup> See "Non-GAAP Financial Measures" section

## QUARTERLY OPERATING REVIEW

(\$000s)	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Total 2009
Rental revenue	9,328	9,303	9,826	10,986	<b>39,443</b>
Operating expenses	(4,132)	(3,907)	(3,319)	(4,723)	<b>(16,081)</b>
Net operating income (NOI) <sup>1</sup>	5,196	5,396	6,507	6,263	<b>23,362</b>
Interest income	7	4	3	1	<b>15</b>
Interest expense	(1,852)	(1,796)	(1,967)	(2,158)	<b>(7,773)</b>
Amortization of investment properties	(962)	(998)	(965)	(1,460)	<b>(4,385)</b>
Amortization of tenant leasing costs	(568)	(592)	(600)	(818)	<b>(2,578)</b>
Administrative expenses	(207)	(179)	(201)	(531)	<b>(1,118)</b>
Earnings from operations	1,614	1,835	2,777	1,297	<b>7,523</b>
Gain on sale of investment property	339	-	-	-	<b>339</b>
Divisional earnings	1,953	1,835	2,777	1,297	<b>7,862</b>

<sup>1</sup> See "Non-GAAP Financial Measures" section

The Investment Property Division experienced an increase in 2009 in revenues, net operating income and earnings from operations. Rental rates and occupancy rates have remained stable during 2009.

Comparison of same asset NOI from portfolio assets held during both years is \$21,406,000 for the year ended December 31, 2009 which compares to \$19,287,000 for the year ended December 31, 2008 – an increase of 11.0% or \$2,119,000. NOI growth from these assets is expected to continue over the next few years in spite of a softening office market as leases continue to turn over at higher renewal rental rates. While this increased growth in operational performance is partly a result of recent acquisitions, the majority of the growth is a result of better performance from the existing portfolio.

Continued focus on asset upgrades and tenant retention will result in increased revenues for the projects. The portfolio has the advantage of a modest lease turnover annually over the next 4 years reducing the risk of significant blocks of space becoming vacant in any one given year.

## SELECTED FINANCIAL BENCHMARKS

(\$000s)	2009	2008	2007	2006	2005
Commercial properties net book value	<b>153,463</b>	126,426	119,871	84,276	71,130
Manufactured home community and related assets net book value	<b>2,748</b>	2,813	2,879	2,941	3,008
Tenant leasing costs	<b>14,031</b>	9,312	8,188	6,509	6,048
Asset book value	<b>170,242</b>	138,551	130,938	93,726	80,186
Financing <sup>1</sup>	<b>(160,743)</b>	(134,638)	(103,906)	(75,685)	(64,314)
Net investment	<b>9,499</b>	3,913	27,032	18,041	15,872
EBITDA <sup>1</sup>	<b>19,666</b>	17,605	12,149	8,969	6,880
NOI as % of rental revenue <sup>2</sup>	<b>59.2%</b>	56.9%	56.7%	55.5%	53.8%
Earnings from operations as % of net investment <sup>2</sup>	<b>112.2%</b>	43.6%	20.1%	17.1%	12.0%
Divisional earnings as % of net investment <sup>2</sup>	<b>117.2%</b>	186.1%	20.1%	82.6%	12.0%
EBITDA as % of asset book value <sup>2</sup>	<b>12.7%</b>	13.1%	10.8%	10.3%	10.1%
% assets financed <sup>2</sup>	<b>94.4%</b>	97.2%	79.4%	80.8%	80.2%

<sup>1</sup> See "Non-GAAP Financial Measures" section

<sup>2</sup> See "Calculations" in "Non-GAAP Financial Measures" section

## PROPERTY HOLDINGS

Location/Name	Year Acquired	Units	Site Size (Square Feet)	% Leased 2009	% Leased 2008
<b>RESIDENTIAL PROPERTIES</b>					
<b>Edmonton, Alberta</b>					
Edward Street Apartments	2006	11	N/A	100	100
<b>Phoenix, Arizona</b>					
The Dakotas at Camelback	2009	50	N/A	92	-
<b>MANUFACTURED HOME COMMUNITY</b>					
<b>Calgary, Alberta</b>					
Watergrove (*)	1995	308	N/A	100	100
<b>OTHER REVENUE ASSETS</b>					
104 Street Parking Lot #1	2001	28	N/A	100	100
104 Street Parking Lot #2	2002	28	N/A	100	100
102 Street Parking Lot	2009	45	15,000	100	-
Royal Bank Parkade	2005	330	N/A	100	100
Jasper Avenue Development Site	2005	N/A	25,000	-	-
Leduc Common (land leases)	2003-2005	N/A	336,000	100	100
<b>Calgary, Alberta</b>					
Crowfoot Circle (land lease)	1999	N/A	43,560	100	100
Chestermere Station (land lease) (*)	2006	N/A	20,000	100	100
Chestermere Station (land lease) (*)	2009	N/A	60,000	100	-
<b>Kelowna, British Columbia</b>					
Richter Street Parking Lot	2007	26	7,500	100	100
<b>Regina, Saskatchewan</b>					
Executive Terrace Parking Lot	2007	59	16,000	100	100

(\*) Joint Venture)





Location/Name	Year Acquired	Office	Rentable Square Feet Retail	Total	% Leased 2009	% Leased 2008
BUILDINGS						
Edmonton, Alberta						
Melton Building	1973	100,803	12,130	112,933	92	93
Corinthia Plaza	1975	-	23,143	23,143	100	100
Westcor Building	1978	59,024	12,811	71,835	100	100
Princeton Place	1999	50,110	8,448	58,558	74	100
Capilano Centre (*)	1999	68,508	28,578	97,086	78	96
100 Street Place	2000	41,221	3,074	44,295	100	90
Birks Building	2001	24,801	9,884	34,685	73	75
Westgate Business Centre	2001	74,845	-	74,845	89	95
Glentel Building	2002	15,968	-	15,968	100	100
Associated Centre	2002	54,272	19,205	73,477	93	91
Leduc Common	2003-2008	-	176,983	176,983	100	98
Sterling Business Centre	2003	67,909	-	67,909	84	99
Stanley Buildings	2004	33,432	-	33,432	93	93
Royal Bank Building	2005	118,493	17,191	135,684	98	89
Westgrove Common	2006/2007	-	6,738	6,738	100	100
Market at Magrath	2006/2009	38,140	40,658	78,798	93	100
Premier Audio Building	2008	-	6,000	6,000	100	100
Miller Crossing	2009	-	11,750	11,750	100	-
Calgary, Alberta						
Kensington Road Building	1980	17,867	5,984	23,851	100	100
Crowfoot Centre	2002	44,924	23,699	68,623	98	99
Chestermere Station (*)	2006-2009	-	86,206	86,206	93	93
Lethbridge, Alberta						
Lethbridge Centre (*)	2007	100,817	321,083	421,900	81	81
Regina, Saskatchewan						
University Park Plaza	1981	-	41,206	41,206	100	100
Executive Terrace	2007	42,843	-	42,843	100	100
Towers Mall	2007	-	115,999	115,999	98	95
Market Mall	2007	-	42,632	42,632	83	50
Parliament Place	2007	24,411	-	24,411	94	95
Kelowna, British Columbia						
Kelowna Business Centre	2006	35,653	36,429	72,082	95	97
Richter Street	2007	28,978	-	28,978	97	95
2009 Total including JV Interest @ 100%		1,043,019	1,049,831	2,092,850	91.4	-
2009 Total Net of JV Interest		958,356	831,897	1,790,253	93.0	-
2008 Total including JV Interest @ 100%		1,001,654	1,000,867	2,002,521	-	94
2008 Total Net of JV Interest		921,679	788,324	1,710,003	-	96

(\* Joint Venture)

## **PROPERTY TRANSACTIONS**

The Division had the following additions and disposals in 2009:

- During the first quarter, the Division acquired a surface parking lot in downtown Edmonton on 102 Street which strategically located adjacent to the Company's Royal Bank Parkade. The Division also sold a 6,150 sq. ft. office building in Regina, Saskatchewan, generating a gain on sale of \$339,000. This building had been owned since 1979.
- During the second quarter, the Division acquired 50 condominium units in Phoenix, Arizona.
- During the year, The Division also acquired five properties transferred from the Property Development Division (as described in section – "Property Development Operations"). These properties include a 65,000 sq. ft. building in south Edmonton (Market at Magrath), a 11,750 sq. ft. pharmacy building in north east Edmonton (Miller Commercial) and a site with three retail buildings comprising 24,800 sq. ft. in Chestermere (Chestermere Station).

The Division has a conditional deal to purchase a 240 unit residential complex comprising 11.5 acres near Houston, Texas for a purchase price of about \$23,000,000. The purchase is expected to close in the second quarter of 2010, subject to approval of the assumption of the existing financing on the property in the amount of approximately \$17,000,000. This asset would add to the Division's growing residential portfolio, consistent with the Phoenix condominium purchase of 50 units made in the second quarter of 2009.

## **FINANCING**

The Division normally finances its assets with fixed rate long-term mortgage financing. The advantages of this strategy include:

- Reduction of interest rate risk as mortgages are financed over fixed terms of five to fifteen years;
- Returns are increased due to leverage; and
- Cash flow from financing helps to fund asset acquisitions thus allowing the Division to expand its asset base.

In 2009, the Division financed four properties for gross proceeds of \$37,800,000, net of joint venture interests. The Division used four lenders and achieved a weighted average interest rate of 5.5%.

See the "Financial Instruments" section of this MD&A for further information.

## **RISK FACTORS**

The two major risks affecting the Division are retaining existing tenants and attracting new tenants. The Division is subject to the market conditions in the geographic areas where it owns properties. As these market conditions change, the ability to achieve higher occupancy rates also changes. Market conditions are influenced by outside factors such as government policies, demographics and employment patterns, the affordability of rental properties, competitive leasing rates and long-term interest and inflation rates.

Management attempts to mitigate these risks by:

- owning properties in the vicinity of major population and employment centres, (normally in areas where we also develop land for resale);
- diversifying the type of investment properties in the portfolio;
- managing and participating in joint ventures;
- purchasing properties that are below replacement value, which improves prospects for future appreciation in lease rates and property values;
- obtaining long-term, fixed-rate financing when the features of the specific property meet conditions that generate competitive financing terms;
- managing our buildings so as to have competitive operating costs; and
- maintaining adequate insurance coverage to protect the Division's income stream, assets and exposure to third party claims.

## **RECREATIONAL PROPERTY OPERATIONS**

This Division owns and manages three 18-hole championship golf courses, two of which are in the Edmonton region (The Links at Spruce Grove and Lewis Estates Golf Course, a 60% joint venture), and one in the Black Mountain region of Kelowna, British Columbia. In addition, the Division owns a 50% interest in the Jagare Ridge Golf Course in south west Edmonton.

Strategic initiatives for 2010 - 2012 include:

- To enhance Divisional performance through revenue growth and cost savings;
- To provide a high standard of service to our customers so as to maximize their enjoyment at our golf courses; and
- To initiate construction of a new clubhouse for the Links Golf Course.

## RECREATIONAL PROPERTY OPERATIONS CONTINUED

### ANNUAL OPERATING REVIEW

(\$000s)	2009	2008	2007	2006	2005
Rental revenue	<b>6,393</b>	4,689	4,324	3,026	3,228
Operating costs	<b>(3,284)</b>	(2,707)	(2,295)	(1,708)	(1,466)
Net operating income (NOI) <sup>1</sup>	<b>3,109</b>	1,982	2,029	1,318	1,762
Interest revenue	-	5	2	-	-
Interest expense	<b>(211)</b>	(270)	(301)	(280)	(178)
Administration expenses	<b>(1,534)</b>	(1,106)	(1,143)	(630)	(631)
Depreciation expense	<b>(1,145)</b>	(853)	(703)	(333)	(244)
Gain/(Loss) on sale of capital assets	<b>43</b>	33	121	14	(63)
Divisional earnings (loss)	<b>262</b>	(209)	5	89	646

<sup>1</sup> See "Non-GAAP Financial Measures" section

### QUARTERLY OPERATING REVIEW

(\$000s)	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Total 2009
Rental revenue	23	2,219	3,706	445	<b>6,393</b>
Operating costs	(275)	(1,039)	(1,276)	(694)	<b>(3,284)</b>
Net operating income (NOI) <sup>1</sup>	(252)	1,180	2,430	(249)	<b>3,109</b>
Interest expense	(59)	(59)	(59)	(34)	<b>(211)</b>
Administrative expenses	(181)	(564)	(506)	(283)	<b>(1,534)</b>
Depreciation expense	(145)	(348)	(414)	(238)	<b>(1,145)</b>
Gain/(Loss) on sale of capital assets	-	19	(6)	30	<b>43</b>
Divisional earnings (loss)	(637)	228	1,445	(774)	<b>262</b>

<sup>1</sup> See "Non-GAAP Financial Measures" section

### SELECTED FINANCIAL BENCHMARKS

(\$000s)	2009	2008	2007	2006	2005
Golf courses and related assets - Asset cost	<b>24,114</b>	20,109	18,336	11,861	9,231
Golf courses and related assets - Accumulated depreciation	<b>(5,555)</b>	(4,533)	(3,751)	(3,336)	(3,168)
Asset cost	<b>18,559</b>	15,576	14,585	8,525	6,063
Financing <sup>1</sup>	<b>(4,367)</b>	(4,750)	(5,091)	(4,790)	(5,117)
Net investment	<b>14,192</b>	10,826	9,494	3,735	946
EBITDA <sup>1</sup>	<b>1,618</b>	909	1,007	702	1,068
NOI as % of revenue <sup>2</sup>	<b>48.6%</b>	42.3%	46.9%	43.6%	54.6%
Divisional earnings as % of net investment <sup>2</sup>	<b>2.1%</b>	(2.1%)	0.1%	3.8%	59.0%
EBITDA as % of asset cost <sup>2</sup>	<b>7.3%</b>	8.9%	6.7%	6.7%	14.1%
% assets financed <sup>2</sup>	<b>23.5%</b>	30.5%	34.9%	56.2%	84.4%

<sup>1</sup> See "Non-GAAP Financial Measures" section

<sup>2</sup> See "Calculations" in "Non-GAAP Financial Measures" section

Current year revenues are higher than 2008 primarily due to the opening of the Black Mountain course in Kelowna, British Columbia. Earnings for 2009 were negatively impacted by start up costs and the fact that it opened in June whereas, going forward, we would expect to open in March. All golf courses had positive contributions to cash from operations which were \$1,364,000 for the year (2008 - \$611,000).

### OPERATIONAL ACTIVITY

The courses are maintained consistent with the adopted objectives of a recognized championship public golf course. This sustains a positive economic balance between the level of the course fees, the number of rounds attracted and the level of enjoyment experienced by our customers as it relates to course conditions. All courses have a reputation of consistently being in excellent condition overall.



### EQUIPMENT / ASSETS

The Division purchases and maintains recognized brand name groundskeeping equipment, which allow grounds crews to perform a superior job. Golf carts are replaced every 6 to 8 years. The Division is planning on initiating the construction of a new clubhouse for the Links at Spruce Grove. Once completed, all clubhouses for the courses which are managed by the Division will be considered state of the art.

### FINANCING

The Division's financing goals are similar to those of the Investment Property Division (i.e. to obtain long-term fixed rate financing).

Currently, the Lewis Estates Golf Course is financed with a variable rate mortgage and is part of a comprehensive financing arrangement which also includes a term loan respecting future development lands. The Links at Spruce Grove was financed with a fixed rate mortgage that matures in July of 2010. There is currently no mortgage financing in place on the Jagare Ridge Golf Course. The development of the Black Mountain Golf Course is financed by the Company's existing credit facility. Plans are underway to place a fixed rate mortgage on the Kelowna course which has been nominated by Score Magazine as the best new golf course in Canada for 2010.

### RISK FACTORS

The primary risk factor is to continue to attract golfers to play at the Division's golf courses. Golf course results are subject to weather, number of playing days, competition from other courses, the amount of disposable income available to customers to spend on recreational activities, popularity of the sport and the cost of providing desirable playing conditions.

Management attempts to mitigate these risks by:

- owning golf courses near high population areas;
- keeping green fees competitive, but sufficient to maintain a high standard of course conditions;
- servicing the corporate golf tournament business, which increases the number of sold out days and provides revenue on marginal weather days;
- building good practice facilities at the courses and by providing excellent professional golf instruction; and
- practicing efficient, courteous and professional customer relations to encourage patrons to return.

### LIQUIDITY

Management believes that with the projected level of operations for 2010 and the availability of funds under the established credit facility and mortgage financings, the Company will have sufficient capital to fund its operations.

The Company is relatively conservative as it relates to its use of debt to finance its operations. This is evidenced by the debt to equity ratio (total debt divided by total equity as per the balance sheet) over the past 5 years which is as follows:

	2009	2008	2007	2006	2005
	1.17 to 1	1.28 to 1	1.54 to 1	1.22 to 1	1.13 to 1

The Company has an ongoing requirement to finance its operations. The Company has a credit facility syndicate with a major chartered bank. Under the terms of this facility, the Company pledges specific agreements receivable, specific lot inventory, undeveloped land inventory and a general security agreement as collateral. This credit facility may be terminated by the bank upon one year's notice and may be modified to meet the Company's needs. A summary of the credit facility is as follows:

(\$000s)	2009	2008	2007	2006
Supportable credit limit	126,800	129,300	155,900	88,900
Credit limit approved	155,700	157,400	109,770	61,800
Credit used	68,026	79,502	85,629	29,599

The Company's supportable credit limit is calculated based on a formula and tests as required by the bank. The supportable credit limit is calculated based on agreements receivable balances and land inventory. As such, the supportable limit fluctuates in response to increases or decreases in these balance sheet accounts. Management monitors the supportable credit limit very closely and keeps the bank informed at all times of its current collections and inventory production plans.

In addition to the credit facility above, the Company can raise equity and obtain debt financing as discussed in the "Capital Resources" section of this MD&A.

The US sub-prime lending debacle, which sent global financial markets into a crisis, will continue to have long term affects on liquidity for most enterprises. The Company's liquidity has been affected both negatively and positively. Real estate, by its nature, is more liquid in good markets and less liquid in poor markets. In the current real estate market, our real estate is somewhat less liquid in the short term, but with real estate markets now correcting, we can see that the liquidity of our assets has improved. The current economics still support the fundamental value of the Company's assets.

## CASH FLOWS

The Company generated \$42,232,000 in cash from operating activities during 2009 versus using cash of \$39,000 in the prior year. This is primarily due to increased cash generated from land development operations as the Community Development Division reduced its inventory of lots from 1,112 to 561 at the end of the year. Combined with the cash generated from the collection of agreements receivable, 2009 generated \$19,130,000 in cash versus using \$52,508,000 in the prior year. Cash generated from operating earnings was higher in 2009 by about \$12,135,000 over the amount generated from operating earnings in the prior year.

The Company used \$24,949,000 in cash from investing activities which compares to receiving \$31,141,000 in cash in the prior year. The main difference is that the Company received \$50,569,000 in proceeds from the sale of assets in 2008 versus \$695,000 from sales proceeds in 2009. During the current year, the Company invested \$25,142,000 on real estate purchases compared to \$16,714,000 in 2008.

The Company used \$14,724,000 in financing activities which is primarily due to debt repayments during the year exceeding loan advances. Operating line borrowings decreased by \$11,076,000. Debt on land inventory decreased by \$14,407,000 during the year (net of new land development financing of \$2,763,000). Debt on investment properties increased by \$16,476,000 which is comprised of new financing of \$37,800,000 less repayments of \$21,324,000. The Company also raised \$1,804,000 (2008 - \$456,000) from the issuance of share capital resulting from the exercising of employee share options. The Company did not spend funds toward the purchase of Common Shares under a normal course issuer bid in 2009 compared to \$6,586,000 spent in 2008. Dividends paid during the year used \$7,521,000 in cash versus \$12,989,000 used in the prior year.

### Contractual obligations include:

	Payments Due by Period				
(\$000s)	Total	Less than 1 Year	1 – 3 Years	4 – 5 Years	After 5 Years
Long term debt	230,666	47,007	72,392	74,785	36,482
Operating leases	385	123	247	15	-
Contractual commitments	-	-	-	-	-
Total contractual obligations	231,051	47,130	72,639	74,800	36,482

## CAPITAL RESOURCES

The Company does not have any capital commitments other than what has already been disclosed.

The Investment Property Division currently has a conditional deal to purchase a property in Houston, which would require approximately \$6,000,000 in cash should the deal close as planned (see the "Investment Property Operations" section of this MD&A for further information.) The Investment Property Division also anticipates \$3,500,000 in cash required for capital improvements to investment properties during 2010.

The Property Development Division has many large projects planned for the upcoming years (see the "Property Development Operations" section of this MD&A for further information.) The Division anticipates spending \$14,000,000 in cash in 2010.

The company uses two sources of funding to finance operations depending on the division:

- The Community Development Division uses a bank line of credit which margins the land development assets of the Company. These credit lines are used to fund the operations of the Company. Due to recent reductions in the prime borrowing rates, the Company has benefited by being able to borrow at rates fluctuating with prime. Even with an increase in the spread over prime, the cost of borrowing on a floating basis is currently lower when compared to historical cost of funds. The Company has experienced some borrowing pressure as the Community Development division has extended repayment terms to its builders for the agreements receivable. This has negatively impacted the Company's margining ability. However, these extensions were part of the business plan to manage through the current real estate adjustment. Pressure is beginning to subside as they are selling their inventory and paying off overdue agreements receivable. Management is working with our main lender to modify the terms of our credit facility to better reflect our borrowing requirements. These changes are proceeding satisfactorily.
- The Investment Property Division uses fixed rate, long term mortgage financing on its revenue producing assets to raise capital. Financing terms have tightened over the past year as many lenders have curtailed lending activity. This is compounded by the loss of the asset backed lending market. The tightening of terms include the reduction of loan amortization (from 25 years to 20 years), lower loan to value ratios (from 75% to 60%), tighter restrictions on debt coverage, increased pricing of loans as premium spreads have increased (from 125 basis points to 250 basis points) and a movement away from non-recourse loans. The effect to the Company has not been significant, given that the market value of the investment property assets have risen as a result of increased rental revenues. As such, the Company is still able to finance increased loan amounts from its existing portfolio of buildings. As of late, the Company has seen a greater appetite from traditional lenders to lend with terms that continue to be more competitive with each passing month. Also, lenders who left the mortgage market a year ago, are now back lending money adding to the number of choices available to borrowers.

The Company could obtain additional cash required for capital expenditures from the following sources:

## EQUITY

The Company does not have any plans to raise equity from the issuance of common or preferred shares, other than related to the Company's share option plan. The Company has issued stock options to its employees. As these options become vested, they can be exercised by the employee, thus raising share capital for the Company. If all outstanding options are exercised at their earliest date, the Company stands to raise \$9,454,000 in share capital by the end of 2012. See the "Outstanding Share Data" section in this MD&A for further information.

## DEBT

The Company could obtain additional financing from the following sources:

- Use of current credit facility. The Company could generate cash through the use of the remaining limit on the Company's current credit facility (see the "Liquidity" section of this MD&A for further information);
- Refinance existing investment property assets for greater mortgage proceeds (see the "Financial Instruments" section of this MD&A for further information). The Company currently has significant equity in properties which are up for renewal during 2010, which could generate net cash proceeds in excess of \$30,000,000;
- Place interim or take-out financing for properties under development within the Property Development Division; and
- Place new financing on unencumbered assets. The Company is currently in discussions with lenders to place financing on several investment properties which could generate cash in excess of \$10,000,000.

## OFF BALANCE SHEET ARRANGEMENTS

### LETTERS OF CREDIT

The Company has an ongoing requirement to provide letters of credit to municipalities as part of the subdivision plan registration process. These securities would provide a source of funds to the municipalities that would allow them to complete the construction of the subdivision should the Company not be able to. The amount of any particular letter of credit is reduced at various stages of construction. Once the municipality issues a certificate acknowledging completion of the project, the letter of credit is cancelled.

The Company records the estimated cost of completion, for all single family lots and parcels (i.e. multi family, commercial and industrial sites) sold as a "Provision for land development costs" liability in the balance sheet. The amount of individual letters of credit will normally exceed the related liability recorded in the accounts due to the timing of the ongoing expenditures which are incurred as the project is being developed compared to the timing of reductions in the balance of the corresponding letter of credit.

The Company's letter of credit facility is part of the Company's overall credit facility that was negotiated with a major Canadian chartered bank. The Company's letter of credit balances over the past three years, net of joint venture interests are:

(\$000s)	2009	2008	2007
Total facility	59,709	60,827	45,127
Amount outstanding	(30,437)	(36,245)	(33,116)
Available for issue	29,272	24,582	12,011

### JOINT VENTURE GUARANTEES

The Company has a history of conducting a significant portion of its business through joint ventures as a way of diversifying development and investment risk. Currently, Melcor is a participant and/or manager of 20 joint ventures. As manager, the Company has arranged appropriate credit facilities for all active joint ventures which margin pre-development work, agreements receivable and lot inventory to provide a line of credit facility to accommodate development activities. In some cases, the Company's guarantee for these facilities goes beyond the Company's proportionate share of the liability. The following table illustrates guarantees made by the Company related to joint venture agreements:

(\$000s)	2009	2008	2007
Net loan guarantees	6,268	9,769	2,265
Letter of credit guarantees	6,597	7,586	5,536
Amounts secured by joint venture agreements	12,865	17,355	7,801

To mitigate the possibility of financial loss, Melcor is diligent in its selection of joint venture participants. As well, Melcor has remedies available within the Joint Venture Agreement, to address the application of the guarantees. In certain instances there are reciprocal guarantees amongst joint venture participants.



## JOINT VENTURE ACTIVITY

The Company uses the proportionate consolidation method to account for its joint ventures. The following table illustrates selected financial data related to joint ventures at 100% as well as the net portion relevant to Melcor.

### JOINT VENTURE ACTIVITY AT 100%

(\$000s)	2009	2008	2007	2006	2005
Revenue	<b>49,101</b>	57,812	93,173	104,665	78,863
Earnings	<b>12,506</b>	21,787	48,822	31,945	24,640
Assets	<b>366,124</b>	335,977	333,854	225,677	202,569
Liabilities	<b>130,188</b>	138,149	109,815	110,881	108,508

### MELCOR'S PORTION (30.0% - 75.0%)

(\$000s)	2009	2008	2007	2006	2005
Revenue	<b>25,553</b>	26,999	50,489	55,572	45,666
Earnings	<b>6,510</b>	10,346	26,398	17,157	14,266
Assets	<b>183,970</b>	191,117	192,600	120,963	108,036
Liabilities	<b>68,790</b>	72,003	67,772	56,045	57,849

The activities of the twenty joint ventures are as follows:

- (2) Commercial Property;
- (1) Manufactured Home Community;
- (2) Active land development and golf course operations;
- (2) Active land development with commercial property development activities;
- (5) Active land development activities;
- (5) Non-active land development with activities expected to commence in 2-4 years; and
- (3) Non-active land development in the process of being wound up.

## CRITICAL ACCOUNTING ESTIMATES

The Company's most significant estimates relate to measuring cost of sales in the Community Development Division which sells parcels of land prior to all costs being committed or known. These estimates are necessary to facilitate the reporting of earnings. The nature of the land development industry includes lengthy time frames to complete all municipal requirements.

When the Community Development Division obtains plan registration for a new phase of a subdivision, the estimated total cost to build the phase is determined and once a lot sale is recorded, the estimated unexpended portion of that cost is set up as a liability in the "Provision for land development costs."

The Division uses independent consultants to help in the preparation of construction budgets, which tend to be conservative in nature. When actual development costs related to the subdivision are incurred, they are applied against the provision.

At least once per year, actual costs are reviewed against the budget and revisions are made when the estimated unexpended portion of the provision is known to be significantly different from the revised estimate to complete the project.

The most significant factors causing revisions to estimates are as follows:

- Increases / decreases to contract amounts from when they are estimated to when they are actually awarded;
- Changes in costs that are contracted by the unit and the number of units vary from the estimate (i.e. volume of earth required to be moved); and
- Other changes typical in a construction environment where future events and uncertainty cannot be reasonably predicted, such as contingencies and allowances for those items which can only be estimated within a range of values and are known only after project completion.

Other significant estimates relate to valuations of agreements receivable and land inventory in the Community Development Division.

Interest bearing agreements receivable arise from and are secured by specific real estate sold in the Community Development Division, and are generally due within one year of origination. Management monitors agreements receivable for indications of impairment on an ongoing basis. Balances are reduced to their estimated realizable amounts when there is doubt regarding collection of the full amount of principal and interest. Estimated realizable amounts are measured by discounting the expected future cash flows at the original effective interest rate inherent in the receivables. When the amounts and timing of future cash flows cannot be estimated with reasonable reliability, estimated realizable amounts are measured at the fair value of the security underlying the receivable, net of expected costs of realization. Significant assumptions relevant to these estimates relate to the financial condition of borrowers, the value of the underlying security, and economic trends impacting the real estate markets in which the Company participates. While this provision reflects management's best estimate, it is subject to measurement uncertainty introduced by the impact of the uncertain economic environment as noted in the assumptions listed above. As a result, material revisions to this estimate may be required in future periods.

Land inventory carried in the community development division is recorded at the lower of cost and net realizable value and comprises undeveloped land costs, capitalized carrying costs related to holding the land, and development costs to build infrastructure. Net realizable value is an entity specific value and refers to the net amount the Company expects to realize from the sale of inventory in the ordinary course of business. Determination of net realizable value of land inventory requires estimation of expected selling prices in the ordinary course of business, and estimates of costs of completion and costs required to make the sale. The Company generally does not acquire raw land for resale, but rather purchases and develops land to be sold as serviced industrial, commercial or residential lots. Management estimates net realizable value by incorporating available market information into estimates of expected sales prices, holding, development and selling costs, and resulting profit margins. While historic and projected profit margins generated by this division have been sufficient to support the carrying value of the Company's land inventory, it is possible that a severe and/or prolonged downturn in the markets serviced by the Company could result in impairment of the carrying amount of inventory. Uncertainty in the current economic environment makes it reasonably possible that estimates of net realizable value may change materially in the near term.

The market conditions of the past four years have been volatile with market demand growing rapidly until mid 2007, followed by a cooling until mid 2008 and a dramatic slowdown through to early 2009. Since then, the market has picked up and would be considered to be closer to historical levels at this time. This recent volatility has dramatically increased the risk of making estimation errors.

## **CHANGES IN ACCOUNTING POLICIES INCLUDING PRONOUNCEMENTS ISSUED BUT NOT YET ADOPTED**

Effective January 1, 2009, the Company adopted CICA Handbook Section 3064, Goodwill and Intangible Assets and the related amendments made to Section 1000, Financial Statement Concepts.

CICA Handbook Section 3064, Goodwill and Intangible Assets, establishes standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets. The standard provides that costs can be capitalized only when they relate to an item that meets the definition of an asset. Section 1000, Financial Statement Concepts, was also amended to provide consistency with this new standard.

As a result of these standards, the Company is no longer able to defer capital maintenance expenditures recoverable from its tenants and match the depreciation of these deferred expenditures to the period revenue is collected from tenants. The new standard requires the Company to capitalize or expense capital maintenance expenditures recoverable from its tenants in the period incurred.

Management has performed a detailed analysis of major repair costs, both recoverable and non-recoverable, included on the balance sheet at December 31, 2008 and determined that these costs are major items of repair or replacements incurred pursuant to a capital plan and meet the applicable asset recognition criteria. Therefore, these costs and any similar future additions will be capitalized to investment properties and amortized on a straight line basis over the expected useful life of such major repair or replacement.

The adoption of this new section impacts the presentation of these items on the financial statements, where the costs and any additions are now presented as components of investment properties and amortized accordingly. Specifically, the adoption of this section resulted in a reclassification of \$5,240,000 from deferred costs and other assets to investment properties at December 31, 2008 and a reclassification of \$756,000 from cost of sales to amortization expense for the year ended December 31, 2008 (\$339,000 for the three months ended December 31, 2008). The adoption of this section had no impact on earnings in the current or prior year.

## **International Financial Reporting Standards**

In February 2008, the AcSB confirmed that IFRS will be mandatory in Canada for profit-oriented publicly accountable entities for fiscal periods beginning on or after January 1, 2011. Our first annual IFRS financial statements will be for the year ending December 31, 2011 and will include the comparative period of 2010. Starting in the first quarter of 2011, we will provide unaudited consolidated interim financial information in accordance with IFRS including comparative figures for 2010.

The Company commenced its IFRS conversion project in 2008. A formal project plan and a project team, including an external advisor, have been established. Regular reporting is provided to senior management, the Audit Committee and the Board of Directors.

The conversion plan consists of the following phases:

**Diagnostic phase** – This phase includes a high-level impact assessment of the differences between current Canadian GAAP and IFRS, focusing on the areas which will have the most significant impact to the Company. A preliminary conversion roadmap has been prepared as part of this phase.

**Design, planning and solution phase** – This phase focuses on determining the specific impact on the Company based on the application of the IFRS requirements. Accounting policies will be finalized, first-time adoption exemptions will be considered, draft financial statements and disclosures will be prepared and a detailed implementation plan and timeline will be developed. This phase also includes the development of a training plan.

**Implementation and review phase** – This phase includes execution of changes to accounting policies and practices, and implementation and testing of business processes, systems and internal controls. It also includes training programs for the company finance and other staff, as necessary.

The Company completed the diagnostic assessment phase in 2008 by performing comparisons of the differences between Canadian GAAP and IFRS. This assessment has provided insight on the high risk and complex areas relating to the conversion. The Company has determined that the most significant impact of IFRS conversion is to Investment Properties. Conversion to IFRS may have a significant impact on how the Company accounts for its Investment Property assets. Under Canadian GAAP, Investment Properties are recorded at cost less accumulated amortization and accumulated impairment losses. IAS 40 "Investment Properties", gives Companies the choice between the cost model or the fair value model. If the Company is to adopt the fair value model under IFRS to account for its Investment Property assets, this will materially affect the Company's financial statements.

Work has commenced on the design, planning and solution phase and the Company has begun assessing the impact and designing solutions to address the differences, focusing initially on those differences that may require changes to our financial systems or that are more complex or time-consuming to resolve. Appropriate resources have been secured to complete the changeover on a timely basis. We have detailed project plans and progress reporting in place to support and communicate the changeover.

## CHANGES IN ACCOUNTING POLICIES INCLUDING PRONOUNCEMENTS ISSUED BUT NOT YET ADOPTED (CONTINUED)

Several IFRS standards are in the process of being amended by the IASB. Amendments to existing standards are expected to continue until the transition date of January 1, 2011. The Company is monitoring the IASB's active projects and all changes to IFRS prior to January 1, 2011 will be incorporated as required.

At the current stage of the project, Melcor cannot reasonably determine the full impact that adopting IFRS would have on its financial position and future results; however, such impact may be material. Additional information will be provided as we move towards the changeover date.

## DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company's management, including the President & Chief Executive Officer and the Vice-President Finance & Chief Financial Officer, has reviewed and evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined in National Instrument 52-109 of the Canadian Securities Administrators) as of December 31, 2009.

Management has concluded that, as of December 31, 2009, the disclosure controls and procedures were effective to provide reasonable assurance that material information relating to the Corporation and its consolidated subsidiaries and joint ventures would be made known to them by others within those entities, particularly during the period in which this report was being prepared. Management has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

During the year ended December 31, 2009, there has been no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

In accordance with NI 52-109, management designed and assessed the effectiveness of internal controls over financial reporting as of December 31, 2009, based on the criteria set forth in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that assessment, management concluded that, as of December 31, 2009, internal control over financial reporting was effective.

Notwithstanding the foregoing, no assurance can be made that the Company's controls over disclosure and financial reporting and related procedures will detect or prevent all failures of people within the Company to disclose material information otherwise required to be set forth in the Company's reports.

## FINANCIAL INSTRUMENTS

Financial instruments consist of cash and cash equivalents, accounts receivable, agreements receivable, bank operating loan, accounts payable and accrued liabilities, debt on land inventory and debt on investment properties. The Company believes that the fair value of financial instruments approximates their carrying values. The fair value of cash and cash equivalents, accounts receivable, bank operating loan and accounts payable and accrued liabilities approximate their carrying value due to their short-term nature.

The fair value of agreements receivable are estimated based on the interest bearing nature of these instruments which are at rates consistent with market rates for debt instruments with similar terms to maturity. The fair value of debt on land inventory and debt on investment properties are estimated based on quoted market rates for similar instruments with similar terms. Management concluded that there is no significant difference between the weighted average interest rate on fixed rate debt and the rates currently available to the Company.

Agreements receivable are a financing tool used by the Company to assist builders to acquire lots. Normal terms include repayment within one year, interest at prime plus two percent after any provision for an interest relief period and an above market interest rate for balances that are past due.

The Company retains full security until the agreement receivable has been collected. The Company seldom incurs bad debt losses in relation to agreements receivable.

In light of economic conditions at December 31, 2008, the Company had recorded a provision for impairment of \$1,200,000 in relation to loans identified as impaired based on a project by project analysis. During the current year, this allowance was fully utilized as concessions were granted to builders. Further allowances of \$1,060,000 were also recorded during the year. As at December 31, 2009, the remaining allowance for impairment is \$566,000. Management has determined on a loan by loan basis that this allowance is sufficient to cover any further collection. The Company does have contractual performance recourse options. A significant amount of the provision may be recoverable in the future if lands are taken back and resold at a later date. The provision represents management's best estimate of the realizable amount of the receivable balances and is subject to the measurement uncertainty described under "critical accounting estimates."

Debt on land inventory is normally comprised of loans on the acquisition of land that are primarily held by the land vendor (fixed rate financing with repayments over 3 to 10 years) or from financial institutions (variable rate financing with repayments over 3 to 5 years). In addition, the Company may obtain financing from a financial institution in order to commence major infrastructure in a new community or obtain project financing when the borrowing requirement falls outside the normal parameters that are currently met with a line of credit. This type of loan usually has floating rates of interest tied to prime. The following table illustrates the changes in debt on land inventory over the past five years:

### DEBT ON LAND INVENTORY

(\$000s)	2009	2008	2007	2006	2005
Balance at beginning of the year	79,688	106,565	72,440	50,478	40,311
New loans	3,038	5,294	54,261	46,205	24,575
Repayments	(17,170)	(32,171)	(20,136)	(24,243)	(14,408)
Balance at end of the year	65,556	79,688	106,565	72,440	50,478
Weighted average interest rate	4.8%	5.4%	5.3%	5.5%	4.9%



Debt on investment properties in the amount of \$165,110,000 reflects financing placed on investment properties that have a net book value of \$157,095,000. The following carry forward table illustrates the changes in debt on investment properties over the past five years:

#### DEBT ON INVESTMENT PROPERTIES

(\$000s)	2009	2008	2007	2006	2005
Balance at beginning of the year	148,634	135,413	89,869	69,432	35,956
New mortgage financing	37,800	49,518	43,450	28,244	35,818
Loans assumed	-	-	4,668	-	-
Repayments	(21,324)	(36,297)	(2,574)	(7,807)	(2,342)
Balance at end of the year	165,110	148,634	135,413	89,869	69,432

Debt on investment properties includes loans which are normally fixed rate and long-term in nature. Rates are negotiated at a pre-agreed benchmark bond rate plus a spread and are negotiated with different lenders to ensure competitive terms and multiple sources. Loan maturity dates are spread out so as to reduce associated loan renewal risks. The following table represents cumulative loan amounts due for renewal over the next thirteen years for fixed rate mortgages (including the golf courses):

Year	Loan Renewal Amount (\$)	Weighted Average Current Interest Rates	Number of Loans
2010	16,477,000	5.1%	6
2011	10,988,000	4.8%	2
2012	27,425,000	6.0%	8
2013	38,132,000	5.3%	8
2014	25,688,000	5.8%	2
2015	7,900,000	5.4%	2
2016	4,588,000	5.6%	1
2018	4,148,000	6.2%	1
2020	8,436,000	5.4%	2

#### OUTSTANDING SHARE DATA

The Company has only one class of Common Shares issued. The issuance of the voting Common Shares is as follows:

OUTSTANDING SHARES (#)	2009	2008	2007	2006	2005
At beginning of the year	29,779,830	31,189,830	31,055,720	30,755,620	30,545,030
Stock options exercised	503,900	121,700	134,110	300,100	830,590
Shares purchased and cancelled	-	(1,531,700)	-	-	(620,000)
At end of the year	30,283,730	29,779,830	31,189,830	31,055,720	30,755,620

OUTSTANDING STOCK OPTIONS (#)	2009	2008	2007	2006	2005
At beginning of the year	1,265,300	993,000	962,110	1,216,610	1,821,600
Stock options granted	286,900	407,700	169,200	53,600	232,000
Stock options exercised	(503,900)	(121,700)	(134,110)	(300,100)	(830,590)
Stock options forfeited	(19,000)	(13,700)	(4,200)	(8,000)	(6,400)
At end of the year	1,029,300	1,265,300	993,000	962,110	1,216,610

The maximum stock options which could be exercised in the future, based on existing employee stock option programs, are in the table below. This could change if new stock options are granted or if existing options expire or are forfeited. Also, it could change if employees defer the exercise of their stock options to periods subsequent to their vesting period.

EXERCISABLE STOCK OPTIONS	2010	2011	2012
Maximum options exercisable in the future (#)	696,933	236,733	95,634
Maximum increase in share capital (\$)	6,732,058	1,675,404	1,046,236

#### FOURTH QUARTER RESULTS

The earnings from the fourth quarter of 2009 were down from the prior year. The decrease in earnings was primarily due to decreased margins in the Community Development Division in most regions, partially offset by increased earnings from the Investment Property Division.

(\$000s)	For the three months ended December 31st			
	2009	2008	2007	2006
Revenue	<b>48,872</b>	41,758	67,693	85,891
Cost of sales	<b>(27,648)</b>	(16,670)	(29,061)	(44,362)
	<b>21,224</b>	25,088	38,632	41,529
Interest revenue	<b>154</b>	1,337	1,982	1,368
Interest expense	<b>(2,969)</b>	(2,820)	(2,893)	(1,710)
General and administrative expenses	<b>(3,540)</b>	(4,293)	(3,172)	(4,562)
Amortization expense	<b>(2,549)</b>	(2,209)	(1,769)	(897)
Gain/(loss) on sale of capital assets	<b>30</b>	50	-	11,003
Foreign exchange gain	<b>111</b>	-	-	-
Earnings before income tax expense	<b>12,461</b>	17,153	32,780	46,731
Income tax expense	<b>(2,543)</b>	(2,749)	(7,517)	(13,155)
Net earnings for the period	<b>9,918</b>	14,404	25,263	33,576
Basic earnings per common share	<b>0.33</b>	0.47	0.82	1.09
Diluted earnings per common share	<b>0.33</b>	0.47	0.79	1.06

Segmented information for the fourth quarter is as follows:

REVENUE (\$000s)	For the three months ended December 31, 2009			For the three months ended December 31, 2008		
	Segment Revenue	Inter-segment Eliminations	External Revenue	Segment Revenue	Inter-segment Eliminations	External Revenue
Community development	<b>37,719</b>	(5)	<b>37,714</b>	34,525	(2,313)	32,212
Property development	<b>4,721</b>	(4,720)	<b>1</b>	3,466	(3,446)	20
Investment property	<b>10,986</b>	(242)	<b>10,744</b>	9,272	(237)	9,035
Recreation property	<b>445</b>	(32)	<b>413</b>	532	(41)	491
	<b>53,871</b>	(4,999)	<b>48,872</b>	47,795	(6,037)	41,758
EARNINGS (\$000s)	Segment Earnings	Inter-segment Eliminations	External Earnings	Segment Earnings	Inter-segment Eliminations	External Earnings
Community development	<b>13,964</b>	41	<b>14,005</b>	19,154	(1,422)	17,732
Property development	<b>577</b>	(760)	<b>(183)</b>	1,167	(1,441)	(274)
Investment property	<b>1,297</b>	-	<b>1,297</b>	1,781	-	1,781
Recreation property	<b>(774)</b>	-	<b>(774)</b>	(658)	-	(658)
	<b>15,064</b>	(719)	<b>14,345</b>	21,444	(2,863)	18,581
Non-allocated items:						
Interest income			<b>15</b>			454
Interest expense			<b>(583)</b>			(742)
General and administrative expenses			<b>(1,427)</b>			(1,140)
Foreign exchange gain			<b>111</b>			-
Earnings before income tax expense			<b>12,461</b>			17,153
Income tax expense			<b>(2,543)</b>			(2,749)
Net earnings for the period			<b>9,918</b>			14,404

## NON-GAAP FINANCIAL MEASURES

Melcor uses several non-GAAP measures in evaluating and measuring certain performance results. These non-GAAP financial measures do not have any standardized meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers.

Non-GAAP measures include:

- Net Operating Income (NOI) – this measures revenue less direct operating expenses.
- Earnings before interest, taxes (income), depreciation and amortization (EBITDA) – this measure is often used in the real estate industry because it isolates earnings before income taxes (at Melcor's Divisional level, income taxes are not applicable), interest expense, depreciation and amortization to measure operating performance. Interest expense can distort the comparable performance of a property as it depends on the amount of financing carried by the property and the interest rate charged on the loan. Depreciation expense can vary depending on depreciation policies, age of the property and depreciable value of the property. Melcor includes amortization of tenant leasing costs as an expense and does not include gains/ (losses) on sales of properties in arriving at EBITDA for the Investment Property division.

A reconciliation of EBITDA to GAAP segmented earnings is as follows:

### INVESTMENT PROPERTY DIVISION

(\$000s)	2009	2008	2007	2006	2005
EBITDA	19,666	17,605	12,149	8,969	6,880
Interest income	15	51	33	36	22
Interest expense	(7,773)	(6,874)	(4,699)	(3,811)	(2,914)
Amortization of investment properties	(4,385)	(4,038)	(2,959)	(2,303)	(1,709)
Gain on sale of investment properties	339	22,052	-	11,108	-
Segmented earnings	7,862	28,796	4,524	13,999	2,279

### RECREATION PROPERTY DIVISION

(\$000s)	2009	2008	2007	2006	2005
EBITDA	1,618	909	1,007	702	1,068
Interest income	-	5	2	-	-
Interest expense	(211)	(270)	(301)	(280)	(178)
Depreciation expense	(1,145)	(853)	(703)	(333)	(244)
Segmented earnings	262	(209)	5	89	646

The following is a reconciliation of Financings amounts used in calculations in the divisional analysis to the GAAP measure of debt on investment properties:

(\$000s)	2009	2008	2007	2006	2005
Investment Property Division financing	160,743	134,638	103,906	75,685	64,314
Recreation Property Division financing	4,367	4,750	5,091	4,790	5,117
Property Development Division financing	-	9,246	26,416	9,394	-
Debt on investment properties	165,110	148,634	135,413	89,869	69,431

### Calculations

The Company uses the following calculations in measuring the performance of its Divisions:

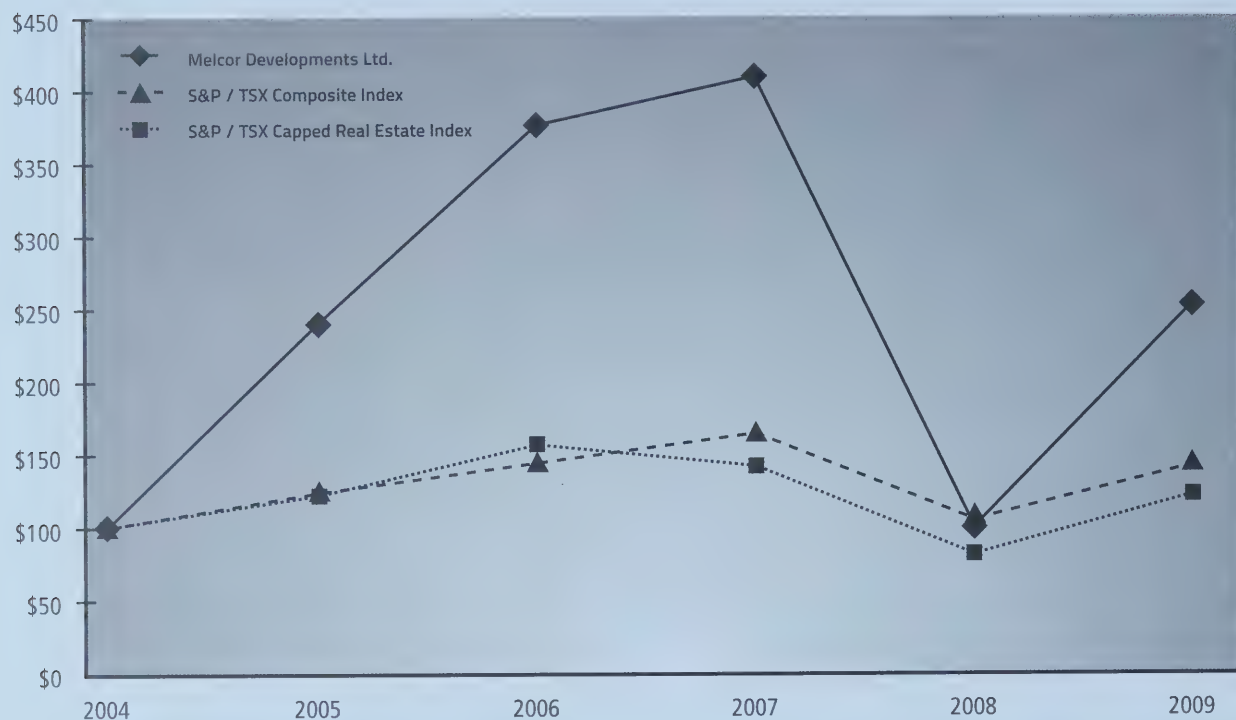
- a) Book value per share = shareholders' equity / number of common shares outstanding
- b) NOI as % of rental revenue = net operating income / revenue
- c) Earnings from operations as % of net investment = Earnings from operations / average net investment, i.e. [(opening net investment + closing net investment) / 2]
- d) Divisional earnings as % of net investment = Division earnings / average net investment, i.e. [(opening net investment + closing net investment) / 2]
- e) EBITDA as % of asset cost or asset book value = EBITDA / average asset cost or asset book value, i.e. [(opening asset cost or book value + closing asset cost or book value) / 2]
- f) % of assets financed = debt / assets
- g) Same building calculation = this compares the results of a building owned if it is owned for the entire current and prior years.



## PERFORMANCE CHART FIVE YEAR CUMULATIVE TOTAL RETURN ON \$100 INVESTMENT

DECEMBER 31, 2004 - DECEMBER 31, 2009

The following chart illustrates Melcor's five-year cumulative total shareholder return, assuming an initial investment of \$100 with all dividends reinvested versus the return on the S&P / TSX Composite Index and the S&P / TSX Capped Real Estate Index.



## CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS

For the years ended December 31 (\$000s)	2009	*2008
Revenue	136,608	108,436
Cost of sales	(77,224)	(55,581)
	59,384	52,855
Interest income	1,906	6,633
Interest expense (Note 16)	(11,491)	(12,031)
General and administrative expenses	(11,101)	(11,749)
Amortization expense	(8,241)	(7,335)
Gain on sale of investment properties and capital assets	382	23,174
Foreign exchange gain	357	-
Earnings before income taxes	31,196	51,547
Income tax (expense) recovery (Note 11)		
Current	(8,418)	(17,190)
Future	446	6,664
	(7,972)	(10,526)
Net earnings for the year	23,224	41,021
Retained earnings, beginning of the year	298,754	276,732
Dividends	(7,521)	(12,989)
Cost of common shares purchased in excess of stated capital	-	(6,010)
Retained earnings, end of the year	314,457	298,754
Basic earnings per share (Note 14)	0.78	1.32
Diluted earnings per share (Note 14)	0.77	1.31

\* Restated – Note 2

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the years ended December 31 (\$000s)	2009	2008
Net earnings for the year	23,224	41,021
Other comprehensive income (loss)		
Unrealized gains (losses) on translation of financial statements of self sustaining foreign operation	(1,282)	1,651
Comprehensive income	21,942	42,672

# CONSOLIDATED BALANCE SHEET

As at December 31 (\$000s)

	2009	*2008
<b>ASSETS</b>		
Cash and cash equivalents	3,947	1,788
Accounts receivable	10,306	9,139
Income taxes recoverable	1,450	5,705
Agreements receivable (Note 3)	81,316	90,056
Land inventory (Note 4)	413,667	424,668
Investment properties (Note 5)	180,123	163,432
Capital assets (Note 6)	439	495
Deferred costs and other assets (Note 7)	16,955	12,699
	<b>708,203</b>	<b>707,982</b>
<b>LIABILITIES</b>		
Bank operating loan (Note 8)	68,026	79,502
Accounts payable and accrued liabilities	17,707	31,698
Provision for land development costs	43,154	35,725
Debt on land inventory (Note 9)	65,556	79,688
Debt on investment properties (Note 10)	165,110	148,634
Future income taxes (Note 11)	22,130	22,576
	<b>381,683</b>	<b>397,823</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 12)	13,003	11,199
Contributed surplus (Note 12 (f))	572	436
Retained earnings	314,457	298,754
Accumulated other comprehensive loss (Note 13)	(1,512)	(230)
	<b>326,520</b>	<b>310,159</b>
	<b>708,203</b>	<b>707,982</b>

\* Restated – Note 2

## SIGNED ON BEHALF OF THE BOARD

PER:  Director

PER:  Director



## CONSOLIDATED STATEMENT OF CASH FLOWS

For the years ended December 31 (\$000s)

	2009	*2008
<b>CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES</b>		
Net earnings for the year	23,224	41,021
Non cash items:		
Amortization of investment properties	5,530	4,882
Amortization of tenant leasing costs	2,578	2,382
Amortization of capital assets	133	71
Stock-based compensation expense (Note 12 (f))	136	120
Gain on sale of investment properties	(382)	(22,085)
Gain on sale of other asset	-	(1,089)
Future income taxes	(446)	(6,664)
	30,773	18,638
Agreements receivable	8,740	50,569
Development activities (Note 21)	19,130	(52,508)
Operating assets and liabilities (Note 21)	(16,411)	(16,738)
	42,232	(39)
<b>CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES</b>		
Purchase of land inventory (Note 4)	(425)	(2,342)
Proceeds from sale of investment properties	695	49,196
Proceeds from sale of other asset	-	1,089
Investment property additions	(25,142)	(16,714)
Capital asset additions	(77)	(88)
	(24,949)	31,141
<b>CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES</b>		
Bank operating loan	(11,076)	(7,812)
Proceeds from land development financing (Note 9)	2,763	4,416
Repayment of debt on land inventory (Note 9)	(17,170)	(32,171)
Proceeds from investment property financing	37,800	49,518
Repayment of debt on investment properties	(21,324)	(36,297)
Dividends paid	(7,521)	(12,989)
Share capital issued (Note 12 (a))	1,804	456
Common shares purchased	-	(6,586)
	(14,724)	(41,465)
Foreign exchange gain/(loss) on cash held in foreign currency	(400)	1,685
Increase (decrease) in cash and cash equivalents during the year	2,159	(8,678)
Cash and cash equivalents, beginning of the year	1,788	10,466
Cash and cash equivalents, end of the year	3,947	1,788

\* Restated – Note 2

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. ACCOUNTING POLICIES

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. The precise determination of many assets and liabilities is dependent upon future events. Accordingly, the preparation of financial statements for a reporting period necessarily involves the use of estimates and approximations which have been made using careful judgement. Significant areas requiring the use of management estimates relate to the determination of the provision for land development costs and potential impairment of assets. Actual results could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

#### a) Basis of consolidation

These consolidated financial statements include:

- (i) The accounts of Melcor Developments Ltd. and its wholly-owned subsidiary companies (the "Company"):  
Melcor Developments Arizona, Inc.  
Melcor Lakeside Inc.  
Stanley Investments Inc.
- (ii) Investments in twenty joint ventures (2008 – twenty) are accounted for using the proportionate consolidation method.

#### b) Recognition of revenue

Revenue is recognized in each business segment as follows:

- (i) Community Development – revenue from the sale of land is recognized when a minimum 15% of the sale price has been received, the sale is unconditional and possession has been granted.
- (ii) Investment Property – rental revenue from properties is recognized over the term of the related lease agreement.
- (iii) Recreation Property – revenue from golf courses is recognized as services are provided.

#### c) Capitalization of costs

- (i) Community Development – The Company capitalizes all direct costs relating to land inventory including carrying costs such as property taxes, interest on debt specifically related to the project and other costs net of any rental income that may be received. General administrative overhead expenses are not allocated or capitalized to properties.
- (ii) Property Development and Investment Property – For acquired and constructed properties, building revenues and operating costs are capitalized as part of the cost of the property until the property is 75% occupied by tenants, subject to a reasonable period dependent on the nature of the property.

#### d) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and short-term deposits with maturity dates of less than three months from the date they were acquired. These items are carried at fair value.

#### e) Land inventory

Land inventory is recorded at the lower of cost and net realizable value and includes undeveloped land costs, capitalized carrying costs related to holding the land and development costs to build infrastructure. The estimated unexpended portion of costs to complete building the infrastructure, which are classified as "Provision for land development costs," are recorded as a liability at the time that a lot sale is recorded. Adjustments are made to the liability with a corresponding adjustment to cost of sales as actual costs are incurred.

The cost of land and carrying costs are allocated to each phase of development on a prorated acreage basis at the time a plan is registered with a municipality. The cost of sale of a lot is allocated on the basis of the estimated total cost of the project prorated by anticipated selling price of the lot over the anticipated selling price of the entire project at the date of plan registration.

#### f) Investment properties

Commercial properties and the manufactured home community are amortized using the straight line method based upon an estimated useful life of 40 to 60 years. Golf courses and related assets are amortized using the straight line method based upon their estimated useful lives at rates from 4% to 30%.

#### g) Capital assets

Capital assets are amortized using the declining balance method of amortization, over their estimated useful lives, at rates from 10% to 30%.

#### h) Deferred costs and other assets

Deferred costs and other assets includes prepaid expenses, sundry assets and tenant leasing cost. These assets are amortized on a straight line basis over the estimated useful lives or lease period and are recorded at the lower of cost less accumulated amortization and net realizable value.

**i) Impairment of long lived assets**

Long lived assets include investment properties, capital assets and tenant leasing costs. An impairment is recognized when the carrying value of an asset exceeds the total undiscounted cash flows expected from its use and eventual disposition. The impairment recognized, is measured as the amount by which the carrying value exceeds its fair value.

**j) Income taxes**

Future income taxes are recognized at substantively enacted tax rates for the future income tax consequences attributable to differences between the carrying values of assets and liabilities and their respective income tax bases. The effect on future income tax assets and liabilities of a change in rates is included in earnings in the period that includes the date of substantive enactment.

**k) Foreign currency translation**

The Company's foreign operation is of a self-sustaining nature. Assets and liabilities of the foreign operation are translated at the exchange rates in effect at the balance sheet date and revenues and expenses are translated at average exchange rates for the year. Gains or losses on translation are recognized as other comprehensive income or loss.

**l) Per share amounts**

The Company uses the treasury stock method for calculation of diluted earnings per share under which deemed proceeds from the exercise of stock options are considered to be used to reacquire common shares at an average share price.

**m) Stock option plan**

The Company uses the fair value based method of accounting for stock options issued to employees. Under this method, the estimated fair value of options on the date of grant is recognized as compensation expense over the period in which the employee services are rendered. The Company accrues compensation cost assuming all options granted will vest, and recognizes the effect of actual forfeitures as they occur.

**n) Asset retirement obligation**

The Company has a conditional asset retirement obligation relating to the removal of asbestos in one of its investment properties. The Company believes that there is insufficient information to estimate the fair value of the asset retirement obligation because the settlement date or the range of potential settlement dates has not been specified by others and information is not available to apply an expected present value technique. As a result, the Company has not recorded a conditional asset retirement obligation in these financial statements.

**o) Financial instruments**

The Company has designated its cash and cash equivalents as held-for-trading, which are measured at fair value. Accounts receivable and agreements receivable are classified as loans and receivables, which are measured at amortized cost subsequent to initial recognition at fair value. Bank operating loan, accounts payable and accrued liabilities, debt on land inventory and debt on investment properties are classified as other financial liabilities, which are measured at amortized cost subsequent to initial recognition at fair value. Transaction costs related to debt financing are expensed as incurred.

## **2. CHANGES IN ACCOUNTING POLICIES AND ESTIMATES**

Effective January 1, 2009, the Company adopted CICA Handbook Section 3064, Goodwill and Intangible Assets and the related amendments made to Section 1000, Financial Statement Concepts.

CICA Handbook Section 3064, Goodwill and Intangible Assets, establishes standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets. The standard provides that costs can be capitalized only when they relate to an item that meets the definition of an asset. Section 1000, Financial Statement Concepts, was also amended to provide consistency with this new standard.

As a result of these standards, the Company is no longer able to defer capital maintenance expenditures recoverable from its tenants and match the depreciation of these deferred expenditures to the period revenue is collected from tenants. The new standard requires the Company to capitalize or expense capital maintenance expenditures recoverable from its tenants in the period incurred.

Management has performed a detailed analysis of major repair costs, both recoverable and non-recoverable, included on the balance sheet at December 31, 2008 and determined that these costs are major items of repair or replacements incurred pursuant to a capital plan and meet the applicable asset recognition criteria. Therefore, these costs and any similar future additions will be capitalized to investment properties and amortized on a straight line basis over the expected useful life of such major repair or replacement.

The adoption of this new section impacts the presentation of these items on the financial statements, where the costs and any additions are now presented as components of investment properties and amortized accordingly. Specifically, the adoption of this section resulted in a reclassification of \$5,240,000 from deferred costs and other assets to investment properties at December 31, 2008 and a reclassification of \$756,000 from cost of sales to amortization expense for the year ended December 31, 2008. The adoption of this section had no impact on earnings in the current or prior year.

## **3. AGREEMENTS RECEIVABLE**

Agreements receivable are due within one year except for \$17,144,000 which is due in 2011 (\$15,284,000 due in 2010). Subsequent to the interest adjustment date, which provides an interest relief period to qualifying registered builders, these receivables earn interest at prime plus two percent (4.25% at December 31, 2009 and 5.50% at December 31, 2008) and are secured by the specific real estate sold. Agreements receivable relate primarily to land sales in Alberta and, accordingly, collection risk is related to the economic conditions of that region.

Management monitors agreements receivable for indications of impairment on an ongoing basis. Balances are reduced to their estimated realizable amounts when there is doubt regarding collection of the full amount of principal and interest. Significant assumptions relevant to these estimates relate



### 3. AGREEMENTS RECEIVABLE (CONTINUED)

to the financial condition of borrowers, the value of the underlying security, and economic trends impacting the real estate markets in which the Company participates. The Company has recorded a provision of \$566,000 (2008 - \$1,200,000) against agreements receivable at December 31, 2009 (note 20). While this provision reflects management's best estimate, it is subject to measurement uncertainty introduced by the impact of the assumptions listed above on the estimation process. As a result, material revisions to this estimate may be required in future periods.

### 4. LAND INVENTORY

(\$000s)	2009	2008
Undeveloped land and carrying costs	245,409	244,582
Pre-development costs	54,701	50,822
Developed land inventory cost	113,557	129,264
	413,667	424,668

During the year the Company purchased land in the amount of \$700,000 (2008 - \$2,240,000) and received vendor financing in the amount of \$275,000 (2008- \$878,000).

Land inventory expensed during the year was \$56,269,000 (2008 - \$38,783,000).

Management has determined that net realizable value exceeds the carrying cost of all land inventory at December 31, 2009, such that no provisions for impairment are required. Determination of net realizable value requires estimation of expected selling prices in the ordinary course of business, and estimates of costs of completion and costs required to make the sale. Uncertainty in the estimation process makes it reasonably possible that these variables may change materially in the near term.

### 5. INVESTMENT PROPERTIES

(\$000s)	2009			*2008		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Commercial properties	175,608	(22,145)	153,463	144,344	(17,918)	126,426
Properties under development	5,353	-	5,353	18,617	-	18,617
Manufactured home community and related assets	3,497	(749)	2,748	3,497	(684)	2,813
Golf courses and related assets	24,114	(5,555)	18,559	20,109	(4,533)	15,576
	208,572	(28,449)	180,123	186,567	(23,135)	163,432

\* Restated – Note 2

### 6. CAPITAL ASSETS

(\$000s)	2009			2008		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Computerware and furniture	1,368	(929)	439	1,336	(841)	495
Other buildings and equipment	31	(31)	-	31	(31)	-
	1,399	(960)	439	1,367	(872)	495

### 7. DEFERRED COSTS AND OTHER ASSETS

(\$000s)	2009	*2008
Tenant leasing costs	14,031	9,312
Other investments	2,070	2,070
Deposits	315	-
Sundry prepaids	172	1,021
Sundry inventory	367	296
	16,955	12,699

\* Restated – Note 2

The Company paid tenant leasing costs of \$7,305,000 during the year (2008 - \$6,975,000), amortized \$2,586,000 (2008 - \$2,382,000) of tenant leasing costs against respective lease revenues, and disposed of \$nil in tenant leasing costs on the sale of an investment property (2008 - \$3,469,000).

## 8. BANK OPERATING LOAN

The Company has an available credit facility with approved loan limits of \$155,700,000 (2008 - \$157,400,000) with a major chartered bank. The portion of these loan limits that pertain solely to the Company is \$120,000,000 (2008 - \$120,000,000) with the remaining balance pertaining to specific joint ventures.

The amount of the total credit facilities currently used is \$68,026,000 (2008 - \$79,502,000). The Company has pledged agreements receivable, specific lot inventory, undeveloped land inventory and a general security agreement as collateral for its credit facility. This facility may be terminated by the bank upon one year's notice. Interest is paid monthly at rates varying from prime plus 1.0% to prime plus 2.25% (2008 - prime plus 0.5% to prime plus 1.0%) resulting in interest rates ranging from 3.25% to 4.50% at December 31, 2009 (2008 - 4.00% to 4.50%).

## 9. DEBT ON LAND INVENTORY

(\$000s)	2009	2008
Agreements payable with interest at the following rates:		
Fixed rates of 5.0% - 6.50%	42,876	57,304
Variable rates of prime plus 1.0% to prime plus 1.25% (3.25% - 3.50% at Dec. 31/09 and 4.50% - 4.75% at Dec. 31/08)	22,680	22,384
	65,556	79,688

During the year, the Company received vendor financing on land purchases of \$275,000 (2008 - \$878,000), obtained bank financing of \$2,763,000 (2008 - \$4,416,000) and made debt repayments of \$17,170,000 (2008 - \$32,171,000).

Specific land inventory with a book value of \$177,021,000 (2008 - \$187,687,000) has been pledged as collateral for the above debt. The weighted average interest rate of agreements payable, based on year end balances, is 4.78% (2008 - 5.40%).

The agreements mature from 2010 to 2017 and the minimum principal payments due within each of the next five years are as follows:

2010 - \$26,161,000; 2011 - \$10,703,000; 2012 - \$15,353,000; 2013 - \$3,173,000; 2014 - \$2,892,000.

## 10. DEBT ON INVESTMENT PROPERTIES

(\$000s)	2009	2008
Mortgage amortized over 10 years with interest at prime plus 1.25% (3.50% at Dec. 31/09 and 4.75% at Dec. 31/08), maturing March 2012	1,439	1,619
Project loan	-	13,246
Project loan with interest at prime plus 2.0% (4.25% at Dec. 31/09), maturing October 2011	5,000	-
Mortgages amortized over 15 to 25 years at fixed rates varying from 4.80% - 7.53% (2008: 4.80% - 7.53%)	158,671	133,769
	165,110	148,634

Specific investment properties with a net book value of \$157,095,000 (2008 - \$133,341,000) and assignment of applicable rents and insurance proceeds have been pledged as collateral for the above debt. The weighted average interest rate for the above debts, based on year end balances, is 5.50% (2008 - 5.40%).

Principal payments due within each of the next five years, assuming renewal at similar terms are: 2010 - \$4,692,000; 2011 - \$9,947,000; 2012 - \$5,222,000; 2013 - \$5,512,000; 2014 - \$5,819,000.

Principal payments due within each of the next five years assuming no renewal are: 2010 - \$20,846,000; 2011 - \$15,115,000; 2012 - \$31,221,000; 2013 - \$41,124,000; 2014 - \$27,596,000.

## 11. INCOME TAXES

Future income tax liabilities consist of the following:

(\$000s)	2009	2008
Investment property book values in excess of tax values	6,264	5,946
Reserve on amounts due in subsequent years	10,460	12,241
Interest and other costs deducted for tax purposes	476	470
Tenant leasing costs	4,930	3,919
	22,130	22,576

The reversal of future income taxes is primarily dependent upon the timing of development and sale of the related assets and on the timing of the receipt of cash relating to agreements receivable.

## 11. INCOME TAXES (CONTINUED)

Income tax expense is calculated as follows:

(\$000s)	2009	2008
Income tax at statutory rate (2009 – 29.0%; 2008 – 29.5%)	9,047	15,206
Increase (decrease) resulting from:		
Benefit recorded for capital gains realized during the year	(44)	(3,931)
Benefit of substantively enacted future tax rate reductions	(1,082)	(819)
Non deductible expenses and other	51	70
Income tax expense	7,972	10,526

Income taxes paid during the year were \$4,163,000 (2008 - \$26,584,000).

## 12. SHARE CAPITAL

### a) Common Shares

	2009		2008	
	Number of Shares Issued	Amount (\$000s)	Number of Shares Issued	Amount (\$000s)
Common shares, beginning of the year	29,779,830	11,199	31,189,830	11,317
Share options exercised	503,900	1,804	121,700	456
Shares purchased and cancelled	-	-	(1,531,700)	(574)
Common shares, end of the year	30,283,730	13,003	29,779,830	11,199

Authorized:

- Unlimited Common Shares
- Unlimited Common Shares, Non-Voting
- Unlimited First Preferred Shares
- Unlimited First Preferred Shares, Non-Voting

### b) Stock-Based Compensation Plan

On September 28, 2000, the Company's Board of Directors approved a stock-based compensation plan (the "2000 Plan"). Under the 2000 Plan, the Company may grant options to full-time, salaried employees and designated contractors after one year of service. The 2000 Plan requires that the option price shall not be less than the weighted average trading price for the 20 consecutive days during which shares traded on the TSX immediately prior to the granting of the stock option. The options vest at 20% per year and expire seven years from the date of issuance. The 2000 Plan was approved by the Company's shareholders at the Shareholders Annual Meeting in May 2001. The Company has 294,500 shares reserved for issuance under the 2000 Plan (2008 - 765,500).

On February 23, 2007 the Company's Board of Directors approved a stock-based compensation plan (the "2007 Plan"). Under this 2007 Plan, the Company may grant options to full-time, salaried employees and designated contractors after one year of service. The 2007 Plan requires that the option price shall not be less than the weighted average trading price for the 20 consecutive days during which shares traded on the TSX immediately prior to the granting of the stock option. At the discretion of the board, the options vest over a period of three years and expire no longer than seven years from the date of issuance. The 2007 Plan was approved by the Company's shareholders at the Shareholders Annual Meeting in April 2007. The Company has 2,967,100 shares reserved for issuance under the 2007 Plan (2008 - 3,000,000).

### c) Stock Options Available for Granting

2000 Plan	2009	2008
Stock options available, beginning of the year	71,400	63,400
Stock options granted	-	-
Stock options forfeited	6,000	8,000
Stock options available, end of the year	77,400	71,400
2007 Plan	2009	2008
Stock options available, beginning of the year	2,428,800	2,830,800
Stock options granted	(286,900)	(407,700)
Stock options forfeited	13,000	5,700
Stock options available, end of the year	2,154,900	2,428,800



**d) Stock Options Outstanding Under the 2000 & 2007 Plans**

	2009		2008	
	# of Options	Weighted Average Option Price	# of Options	Weighted Average Option Price
Stock options outstanding, beginning of the year	1,265,300	6.553	993,000	7.531
Stock options granted	286,900	10.940	407,700	3.710
Stock options exercised	(503,900)	3.580	(121,700)	3.749
Stock options forfeited	(19,000)	9.063	(13,700)	17.740
Stock options outstanding, end of the year	1,029,300	9.185	1,265,300	6.553

**e) Stock Options Outstanding and Exercisable Under the 2000 & 2007 Plans**

Stock Option Expiry Date	Outstanding Stock Options (#)	Exercise Price Per Share (\$)	Stock Options Exercisable at Dec. 31, 2009
October 28, 2010	13,600	3.930	13,600
July 27, 2011	3,600	4.624	3,600
July 26, 2012	158,900	7.064	116,500
December 17, 2012	159,500	19.340	106,333
July 27, 2013	41,000	16.600	24,600
December 15, 2013	365,800	3.710	100,000
December 17, 2014	286,900	10.940	-
	1,029,300		364,633

**f) Stock-Based Compensation Expense**

The following weighted-average assumptions were used in the Black-Scholes calculations for stock options granted:

	2009	2008
Expected volatility	54%	20%
Risk-free interest rate	1.92%	2.64%
Annual dividend rate	3.81%	7.82%
Expected life of options in years	3	3

The weighted average grant date fair value of stock options granted during the year was \$3.35 per stock option (2008 - \$0.13). Current year vesting of options resulted in a \$136,000 (2008 - \$120,000) charge to stock-based compensation expense and corresponding credit to contributed surplus.

**13. ACCUMULATED OTHER COMPREHENSIVE LOSS**

(\$000s)	2009	2008
Balance, beginning of the year	(230)	(1,881)
Other comprehensive income (loss)	(1,282)	1,651
Balance, end of the year	(1,512)	(230)

This adjustment represents the net unrealized foreign currency translation gain (loss) on the Company's net investment in its self-sustaining foreign operation.

**14. PER SHARE AMOUNTS**

(#)	2009	2008
Basic weighted average common shares outstanding during the year	29,847,538	31,112,021
Dilutive effect of options	211,853	287,106
Diluted weighted average common shares	30,059,391	31,399,127

Basic net earnings per share is calculated by dividing the Company's net earnings by the weighted average number of common shares outstanding during the year. Diluted earnings per common share is calculated to give dilutive effect to share options.

#### 14. PER SHARE AMOUNTS (CONTINUED)

Stock options expiring on December 17, 2012 and July 27, 2013, totalling 200,500 options, have been excluded from the calculation of 2009 diluted earnings per share due to their anti-dilutive effect (2008 – 251,033 options expiring on July 27, 2011, July 26, 2012, December 17, 2012, and July 27, 2013).

#### 15. FINANCIAL GUARANTEES

In the normal course of operations, the Company issues letters of credit as security for the completion of obligations pursuant to development agreements signed with municipalities. At December 31, 2009 the Company had \$30,437,000 (2008 - \$36,245,000) in letters of credit outstanding and recorded a net liability of \$43,154,000 (2008 - \$35,725,000) in provision for land development costs in respect of these development agreements.

Normally, obligations secured by the letters of credit diminish as the developments proceed, through a series of staged reductions over a period of years (average of three to four years) and are ultimately extinguished when the municipality has issued final completion certificates.

The Company enters into joint venture agreements and, in doing so, may take on risk beyond its proportionate interest in the joint venture. These situations generally arise where preferred financing terms can be arranged on the condition that the strength of the Company's covenant will backstop that of the other joint venture participant(s) who also provide similar guarantees. The Company will have to perform on its guarantee only if a joint venture participant was in default of their guarantee. At December 31, 2009 the Company had guaranteed \$6,268,000 (2008 - \$9,769,000) in loans and \$6,597,000 (2008 - \$7,586,000) in letters of credit in support of other participant's interests.

The loan guarantees include those which are ongoing, as they relate to the relevant lines of credit, and those which have staged reductions as they relate to the financing of specific assets or projects such as infrastructure loans, short-term land loans or mortgages.

To mitigate the possibility of financial loss, the Company is diligent in its selection of joint venture participants. As well, the Company has remedies available within the joint venture agreement, to address the application of the guarantees. In certain instances there are reciprocal guarantees amongst joint venture participants.

#### 16. INTEREST EXPENSE

(\$000s)	2009	2008
Interest on bank operating loan	3,960	5,379
Interest on debt – land and properties under development	3,277	4,533
Interest on debt – investment properties	7,531	6,652
	14,768	16,564
Less capitalized interest	(3,277)	(4,533)
	11,491	12,031

Cumulative interest capitalized on land inventory at the end of the year is \$17,700,000 (2008 - \$16,490,000). Interest paid during the year was \$14,893,000 (2008 - \$16,890,000).

#### 17. JOINT VENTURES

(\$000s)	CASH FLOWS FROM (USED IN)						
	Assets	Liabilities	Revenue	Earnings	Operating Activities	Investing Activities	Financing Activities
2009	183,970	68,790	25,553	6,510	15,427	(4,039)	(12,033)
2008	191,117	72,003	26,999	10,346	4,131	(2,816)	9,970

The above table includes the Company's proportionate share of the assets, liabilities, revenue, earnings and cash flow information of twenty joint ventures (2008 – twenty) that are proportionately consolidated in these financial statements. The Company's proportionate interest of these joint ventures ranges from 30% - 75% ownership.

## 18. SEGMENTED INFORMATION

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business unit requires different management skills and marketing strategies. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

In the following schedules, earnings from operations before income tax expense has been calculated for each segment by deducting from revenues of the segment all direct costs and administrative expenses which can be specifically attributed to the segment, as this is the basis for measurement of segment performance. Common costs, which have not been allocated, are the costs of corporate debt and general corporate expenses.

The allocation of these costs on an arbitrary basis to the segments would not assist in the evaluation of the segments' contributions.

Inter-segment transactions are entered into under terms and conditions similar to those with unrelated third parties. Any inter-segment sales and the unrealized profits therefrom, have been eliminated.

### *Community Development*

This division is responsible for purchasing and developing land to be sold as residential, industrial and commercial lots.

### *Property Development*

This division develops investment properties which, when constructed and at least 75% leased, are transferred to the Investment Property division which will hold and manage the asset. The transfer is at the Company's estimate of fair value and is recorded as revenue in the Property Development division.

### *Investment Property*

This division owns 43 properties (2008 – 38 properties), which it holds to earn rental income.

### *Recreation Property*

This division owns and manages three 18-hole golf course operations (one of which is 60% owned), and has a 50% ownership interest in one 18-hole golf course.

## FOREIGN SUBSIDIARY

A wholly owned subsidiary with operations in the central United States, which includes a receivable related to a sale of land by the Community Development segment in a prior year and rental income on a residential property within the Investment Property segment. A summary of its activities are as follows:

(\$000s)	2009	2008
External revenue	302	25
Earnings	70	66
Interest Income	-	157
Assets	12,546	9,330
Equity	8,072	9,285

**18. SEGMENTED INFORMATION (CONTINUED)**

	For the year ended December 31, 2009			For the year ended December 31, 2008		
	Segment Revenue	Inter-segment Eliminations	External Revenue	Segment Revenue	Inter-segment Eliminations	External Revenue
<b>REVENUE (\$000s)</b>						
Community development	91,839	(67)	91,772	72,401	(4,305)	68,096
Property development	36,825	(36,750)	75	62,615	(62,596)	19
Investment property	39,443	(970)	38,473	36,510	(741)	35,769
Recreation property	6,393	(105)	6,288	4,689	(137)	4,552
	174,500	(37,892)	136,608	176,215	(67,779)	108,436
<b>EARNINGS (\$000s)</b>						
Community development	30,102	41	30,143	32,667	(2,766)	29,901
Property development	10,712	(11,387)	(675)	23,582	(24,291)	(709)
Investment property	7,862	-	7,862	28,796	-	28,796
Recreation property	262	-	262	(209)	-	(209)
	48,938	(11,346)	37,592	84,836	(27,057)	57,779
<b>Non-allocated items:</b>						
Interest income			172			1,562
Interest expense			(2,676)			(3,596)
General and administrative expenses			(4,249)			(5,287)
Gain on sale of other asset			-			1,089
Foreign exchange gain			357			-
Earnings before income tax expense			31,196			51,547
Income tax expense			(7,972)			(10,526)
<b>Net earnings for the year</b>			23,224			41,021

	Per Segment	Inter-segment Eliminations	Per Financial Statement	Per Segment	Inter-segment Eliminations	Per Financial Statement
<b>INTEREST (\$000s)</b>						
<b>Interest Income:</b>						
Community development	1,719	-	1,719	5,015	-	5,015
Property development	-	-	-	-	-	-
Investment property	15	-	15	51	-	51
Recreation property	-	-	-	5	-	5
Non-allocated	172	-	172	1,562	-	1,562
	1,906	-	1,906	6,633	-	6,633
<b>Interest Expense:</b>						
Community development	(831)	-	(831)	(1,291)	-	(1,291)
Property development	-	-	-	-	-	-
Investment property	(7,773)	-	(7,773)	(6,874)	-	(6,874)
Recreation property	(211)	-	(211)	(270)	-	(270)
Non-allocated	(2,676)	-	(2,676)	(3,596)	-	(3,596)
	(11,491)	-	(11,491)	(12,031)	-	(12,031)

**OTHER SEGMENTED INFORMATION**

	Amortization			Capital Expenditures	Total carrying value of identifiable assets	
(\$000s)	2009	2008	2009	2008	2009	2008
Community development	-	-	-	-	502,038	521,827
Property development	-	-	9,625	10,748	6,080	19,173
Investment property	6,963	6,420	10,141	2,224	173,692	141,269
Recreation property	1,145	853	4,050	1,868	19,310	15,948
Common	133	62	77	88	7,083	9,765
	8,241	7,335	23,893	14,928	708,203	707,982



## 19. MANAGEMENT OF CAPITAL RESOURCES

The Company defines capital as share capital, contributed surplus, accumulated other comprehensive income and retained earnings. The Company's objective when managing capital is to manage and utilize debt to improve the performance of the Company, support the growth of its assets, and finance capital requirements arising from the cyclical nature of the Company's business. Specifically, the Company plans to utilize shorter term debt for financing infrastructure, inventory, receivables and development activities and to utilize longer term debt and equity for the purchase of property and land assets. The Company manages the capital structure through adjusting the amount of long-term debt, credit facilities, the amount of dividends paid and through normal course issuer bids. There were no changes to the Company's objectives, policies and processes for managing capital from the prior fiscal period.

As of December 31, 2009, the Company's debt to total capital is calculated as follows:

(\$000's)	2009	2008
<b>DEBT</b>		
Total liabilities	<b>381,683</b>	397,823
Provision for land development costs	<b>(43,154)</b>	(35,725)
Future income taxes (1)	<b>(22,130)</b>	(22,576)
	<b>316,399</b>	339,522
<b>CAPITAL</b>		
Book value of shareholders' equity	<b>326,520</b>	310,159
Future income taxes (1)	<b>22,130</b>	22,576
	<b>348,650</b>	332,735
<b>Debt to total capital ratio</b>	<b>0.91</b>	1.02

(1) Future income taxes is a required adjustment to debt and capital for financial covenant reporting.

The Company is subject to financial covenants imposed by a financial institution which require the debt to total capital ratio not exceed 1.5 to 1, the book value of shareholders' equity not be less than \$175,000,000 and an interest coverage ratio. The Company was in compliance with these financial covenants during the year. Management prepares financial forecasts to monitor the changes in its debt and capital levels and ability to meet its financial covenants.

## 20. FINANCIAL INSTRUMENTS

Financial instruments consists of cash and cash equivalents, accounts receivable, agreements receivable, bank operating loan, accounts payable and accrued liabilities, debt on land inventory, and debt on investment properties. The fair value of accounts receivable, bank operating loan, accounts payable and accrued liabilities approximate their carrying value due to their short-term nature.

The fair value of agreements receivable are estimated based on the interest bearing nature of these instruments which are at rates consistent with market rates for debt instruments with similar terms to maturity. The fair value of debt on land inventory and debt on investment properties are estimated based on quoted market rates for similar instruments with similar terms. Management concluded that there is no significant difference between the weighted average interest rate on fixed rate debt and the rates currently available to the Company.

The following table shows the carrying values and fair values of the Company's financial instruments:

(\$000's)	December 31, 2009		December 31, 2008	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Held for trading</b>				
Cash and cash equivalents	<b>3,947</b>	<b>3,947</b>	1,788	1,788
<b>Loans and receivables</b>				
Accounts receivable	<b>10,306</b>	<b>10,306</b>	9,139	9,139
Agreements receivable	<b>81,316</b>	<b>81,316</b>	90,056	90,056
<b>Other financial liabilities</b>				
Bank indebtedness	<b>68,026</b>	<b>68,026</b>	79,502	79,502
Accounts payable and accrued liabilities	<b>17,707</b>	<b>17,707</b>	31,698	31,698
Debt on land inventory	<b>65,556</b>	<b>65,556</b>	79,688	79,688
Debt on investment properties	<b>165,110</b>	<b>165,110</b>	148,634	148,634

The Company is exposed to the following risks as a result of holding financial instruments:

### a) Credit Risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Company's financial assets that are exposed to credit risk consist of cash and cash equivalents, accounts receivable, and agreements receivable. The Company's maximum exposure to credit risk is the carrying amount of cash and cash equivalents, accounts receivable and agreements receivable.

## 20. FINANCIAL INSTRUMENTS (CONTINUED)

The Company invests its cash in bank accounts and short-term deposits with a major Canadian chartered bank. Accounts receivable balances include amounts due from other joint venture participants for their portion of management fees due to the Company as well as other various smaller balances due from municipal governments, other developers and tenants. There have been no impairment adjustments made to these accounts.

The Company manages its credit quality risk in the Investment Property division through careful selection of tenants and looks to obtain national tenants or tenants in businesses with a long standing history, or performs financial background checks including business plan review for smaller tenants. The Company manages its credit concentration risk in the Investment Property division by renting to an expansive tenant base, with no dependency on rents from any one specific tenant.

Agreements receivable are secured by specific real estate sold. Agreements receivable relate primarily to land sales in Alberta and, accordingly, collection risk is related to the economic conditions of that region. The Company manages credit risk by selling to certain qualified registered builders. Concentration risk is low as the Company sells to a large builder base, and no receivables are concentrated to one specific builder.

Management has reviewed all agreements receivable balances as at December 31, 2009 and considered the following in assessing its credit risk:

- (1) The credit quality of agreements receivable that are neither passed due nor impaired is determined based on whether balances are due from builders on the Company's approved builder list, and based on geographical location. The approved builder list contains those builders which have a long standing track record, good volumes, positive perception in the industry, and a strong history of repayment. At December 31, 2009, 91% of agreements receivable are due from approved builders.
- (2) Agreements receivable which are past due but were not considered impaired:

(\$000s)	2009	2008
0 - 6 months passed due	3,270	761
Greater than 6 months passed due	614	919

The Company has reviewed these agreements and expects full repayment in respect to these balances.

- (3) Total loans included in agreements receivable that would have otherwise been passed due or impaired at December 31, 2009, but whose terms have been renegotiated is \$19,860,000 (2008 - \$32,232,000). Concessions provided have been written off against the provision.

At December 31, 2009, the Company has identified \$6,806,000 (2008 - \$31,737,000) in agreements receivable which have indications of possible impairment. The factors that were considered in determining that these assets were impaired were primarily the geographic location in which the receivables were associated and agreements receivable in arrears. Management has determined on a loan by loan basis that an impairment provision of \$566,000 is sufficient to cover any further collection risk on these loans (2008 - \$1,200,000).

A summary of the movement in the provision for impairment and restructuring write offs made during the year is as follows:

(\$000s)	2009	2008
Balance, beginning of the year	1,200	-
Provisions recorded during the year	1,060	2,130
Write offs based on concessions provided	(1,694)	(930)
Balance, end of the year	566	1,200

### b) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk to ensure sufficient liquid financial resources to finance operations and meet long-term debt repayments. Management monitors rolling forecasts of the Company's liquidity, which includes cash and cash equivalents and the undrawn portion of the operating loan, on the basis of expected cash flows. In addition, management monitors balance sheet liquidity ratios against loan covenant requirements and maintains ongoing debt financing plans. The Company believes that it has access to sufficient capital through internally generated cash flows, external sources and undrawn committed borrowing facilities to meet current spending forecasts.

The following table shows the maturity analysis of financial liabilities based on remaining contractual maturities (assuming no renewals):

December 31, 2009 (\$000s)	Accounts payable and accrued liabilities	Bank operating loan	Debt on land inventory	Debt on investment properties
2010	17,707	68,026	26,161	20,846
2011	-	-	10,703	15,115
2012	-	-	15,353	31,221
2013	-	-	3,173	41,124
2014 and thereafter	-	-	10,167	56,804
	17,707	68,026	65,556	165,110

December 31, 2008 (\$000s)	Accounts payable and accrued liabilities	Bank operating loan	Debt on land inventory	Debt on investment properties
2009	31,698	79,502	30,659	23,492
2010	-	-	15,394	19,652
2011	-	-	10,500	9,202
2012	-	-	13,693	30,203
2013 and thereafter	-	-	9,442	66,085
	31,698	79,502	79,688	148,634

**c) Market Risk**

The Company is subject to interest rate cash flow risk as its credit facilities and certain of its debts on land inventory and investment properties bear interest at rates that vary in accordance with prime borrowing rates in Canada. For each 1% change in the rate of interest on loans subject to floating rates, the change in annual interest expense is approximately \$971,000 (2008 - \$1,168,000) based upon applicable year end debt balances. This amount is partially offset by the interest earned on agreements receivable which is also subject to interest rate fluctuations. The Company is not subject to other significant market risks pertaining to its financial instruments.

The Company has net assets which are exposed to foreign currency translation risk. The Company does not actively manage the risk for currency exposure. A \$0.01 change in US exchange rates would result in a change in the foreign exchange gain or loss of approximately \$77,000 (2008 - \$76,000).

**21. DEFINITIONS FOR STATEMENT OF CASH FLOWS**

Development activities is defined as the net change in land inventory and the provision for land development costs and excludes the purchase of land inventory. Purchase of land inventory is the cost of land net of vendor financing received (see Note 4 – Land Inventory).

Operating assets and liabilities is defined as the net change of accounts receivable, deferred costs and other assets, income taxes payable and accounts payable and accrued liabilities. Excluded from operating assets and liabilities are investment property additions that are unpaid and in accounts payable as at year end.

## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The Annual Report, including the consolidated financial statements, is the responsibility of the management of the Company. The financial statements have been prepared in accordance with the recommendations of the Canadian Institute of Chartered Accountants in all material respects. Financial information contained elsewhere in this Report is consistent with the information contained in the financial statements.

Management maintains a system of internal controls which provides reasonable assurance that the assets of the Company, its subsidiaries and joint ventures are safeguarded and which facilitates the preparation of relevant, timely and reliable financial information which reflects, where necessary, management's best estimates and judgments based on informed knowledge of the facts.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities and for final approval of the consolidated financial statements. The Board has appointed an Audit Committee comprising three unrelated and independent directors to approve, monitor, evaluate, advise or make recommendations on matters affecting the external audit, the financial reporting and the accounting controls, policies and practices of the Company under its terms of reference.

The Audit Committee meets at least four times per year with management and with the independent auditors to satisfy itself that they are properly discharging their responsibilities. The consolidated financial statements and the Management Discussion and Analysis have been reviewed the Audit Committee and approved by the Board of Directors of Melcor Developments Ltd.

PricewaterhouseCoopers LLP, independent external auditors appointed by the shareholders, have examined the consolidated financial statements and have read the Management's Discussion and Analysis. Their report as auditors is set forth below.

## AUDITORS' REPORT

To the Shareholders of Melcor Developments Ltd.

We have audited the consolidated balance sheets of Melcor Developments Ltd. as at December 31, 2009 and 2008 and the consolidated statements of earnings and retained earnings, comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

Chartered Accountants  
Edmonton, Alberta  
March 3, 2010



## FIVE YEAR REVIEW

BALANCE SHEET (\$000s)		2009	2008	2007	2006	2005
<b>ASSETS</b>						
Cash and cash equivalents		3,947	7,188	10,466	11,564	9,021
Accounts and receivable		10,306	9,139	6,366	5,696	4,570
Income taxes recoverable		1,450	5,705	-	-	-
Agreements receivable		81,316	90,056	140,625	127,178	85,335
Land inventory		413,667	424,668	384,974	255,570	201,398
Investment properties		180,123	163,432	172,565	115,581	88,990
Capital assets		439	495	478	331	327
Deferred cost and other assets		16,955	12,699	11,291	7,007	6,472
		708,203	707,982	726,765	522,927	396,113
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>						
Bank operating loan		68,026	79,502	85,629	29,599	16,026
Accounts payable and accrued liabilities		17,707	31,698	28,642	26,563	21,125
Income taxes payable		-	-	3,689	3,997	5,973
Provision for land development costs		43,154	35,725	51,103	39,805	29,026
Debt on land inventory		65,556	79,688	106,565	72,440	50,478
Debt on investment properties		165,110	148,634	135,413	89,869	69,432
Future income taxes		22,130	22,576	29,240	24,744	17,725
Share capital		13,003	11,199	11,317	10,789	10,023
Retained earnings		313,517	299,960	275,167	225,121	176,305
		708,203	707,982	726,765	522,927	396,113
<b>STATEMENT OF EARNINGS (\$000s)</b>						
Revenue		136,608	108,436	207,024	203,402	161,500
Cost of sales		(77,224)	(55,581)	(96,613)	(114,286)	(85,125)
		59,384	52,855	110,411	89,116	76,375
Interest income		1,906	6,633	6,772	4,439	1,887
Interest expense		(11,491)	(12,031)	(8,968)	(6,427)	(3,896)
General and administrative expense		(11,101)	(11,749)	(13,814)	(11,786)	(9,442)
Amortization expense		(8,241)	(7,335)	(5,178)	(3,840)	(2,900)
		30,457	28,373	89,223	71,502	62,024
Other gains (losses)		739	23,174	121	11,118	(63)
Earnings before income tax expense		31,196	51,547	89,344	82,620	61,961
Income tax expense		(7,972)	(10,526)	(25,674)	(24,849)	(20,185)
Net earnings for the year		23,224	41,021	63,670	57,771	41,776
<b>STATISTICAL (\$)</b>						
Earnings per share - basic		0.78	1.32	2.05	1.87	1.38
Earnings per share - diluted		0.77	1.31	2.00	1.83	1.35
Number of shares - year end (000s)		30,284	29,780	31,190	31,056	30,756
Shareholders equity - book value per share		10.78	10.42	9.19	7.60	6.06
- total (000s)		326,520	310,159	286,484	235,910	186,328
Dividends - per share		0.25	0.42	0.40	0.30	0.25
Share price range		4.00-11.49	3.25-20.27	16.51-30.47	11.50-22.25	5.10-12.00

## MELCOR 2009 PERFORMANCE MEASURES (SELECTED)

	2005	% change	2006	% change	2007	% change	2008	% change	2009
<b>ASSETS (\$000s)</b>	396,113		522,927		726,765		707,982		<b>708,203</b>
Average annual increase = 19.7%		32.0%		39.0%		-2.6%		0.0%	
<b>SHAREHOLDERS' EQUITY (\$000s)</b>	186,328		235,910		286,484		310,159		<b>326,520</b>
Average annual increase = 18.8%		26.6%		21.4%		8.3%		5.3%	
<b>REVENUE (\$000s)</b>	161,500		203,402		207,024		108,436		<b>136,608</b>
Average annual change = -3.9%		25.9%		1.8%		-47.6%		26.0%	
<b>GROSS MARGIN</b>	46.5%		43.0%		52.4%		48.0%		<b>43.5%</b>
Five year average = 46.8%									
<b>ADMIN. EXPENSES/REVENUE</b>	5.8%		5.8%		6.7%		10.8%		<b>8.1%</b>
Five year average = 7.1%		0.0%		15.5%		61.2%		-25.0%	
<b>EARNINGS BEFORE TAXES (\$000s)</b>	61,961		82,620		89,344		51,547		<b>31,196</b>
Average annual change = -12.4%		33.3%		8.1%		-42.3%		-39.5%	
<b>BASIC EARNINGS PER SHARE (\$)</b>	1.38		1.87		2.05		1.32		<b>0.78</b>
Average annual change = -10.9%		35.5%		9.6%		-35.6%		-40.9%	
<b>AVERAGE SHARE PRICE (\$)</b>	8.50		17.90		24.21		9.43		<b>7.49</b>
Average annual change = -3.0%		110.6%		35.3%		-61.0%		-20.6%	
<b>DIVIDEND (\$)</b>	0.25		0.30		0.40		0.42		<b>0.25</b>
Average annual increase = NIL		20.0%		33.3%		5.0%		-40.5%	
<b>DIVIDEND YIELD</b>	2.9%		1.7%		1.7%		4.5%		<b>3.3%</b>
Five year average = 2.4%									
<b>BOOK VALUE PER SHARE (\$)</b>	6.06		7.60		9.19		10.42		<b>10.78</b>
Average annual increase = 19.5%		25.4%		20.9%		13.4%		3.5%	
<b>AVG. BOOK VALUE PER SHARE (\$)</b>	5.55		6.83		8.40		9.81		<b>10.60</b>
Average annual increase = 22.8%		23.2%		22.9%		16.9%		8.1%	
<b>AVG. MARKET/AVG. BOOK</b>	1.53		2.62		2.88		0.96		<b>0.71</b>
Five year average = 1.64									
<b>PRICE EARNINGS RATIO</b>	6.2		9.6		11.8		7.1		<b>9.6</b>
Five year average = 9.1									
<b>RETURN ON EQUITY</b>	24.6%		27.4%		24.4%		13.8%		<b>7.3%</b>
Five year average = 18.1%									
<b>RETURN ON ASSETS</b>	12.3%		12.6%		10.2%		5.7%		<b>3.3%</b>
Five year average = 8.0%									
<b>DEBT/EQUITY RATIO</b>	1.13		1.22		1.54		1.28		<b>1.17</b>
Five year average = 1.28									
<b>ASSET TURNOVER</b>	47.6%		44.3%		33.1%		15.1%		<b>19.3%</b>
Five year average = 28.7%									

### CALCULATIONS:

Price Earnings Ratio is the average share price for the year divided by the basic earnings per share for that year.

Return on Equity is the net earnings after income tax expense for the year divided by the average equity during the year.

Return on Assets is the net earnings after income tax expense for the year divided by the average assets during the year.

## CORPORATE INFORMATION

### CORPORATE OFFICE

900, 10310 Jasper Avenue  
Edmonton, Alberta T5J 1Y8  
(780) 423-6931  
info@melcor.ca  
www.melcor.ca

### DIRECTORS

#### Timothy C. Melton

Executive Chairman  
Melcor Developments Ltd.

#### William D. Grace (1) (2)

Lead Director

#### Gordon J. Clanachan (1)

Corporate Director

#### Ross A. Grieve (2)

Executive Chairman  
PCL Construction Group Inc.

#### Andrew J. Melton

Principal  
Avison Young Commercial Real Estate

#### Catherine M. Roozen (1)

Director & Corporate Secretary  
Cathton Holdings Ltd.

#### Allan E. Scott (2)

Corporate Director

#### Ralph B. Young

President & Chief  
Executive Officer  
Melcor Developments Ltd.

### EXECUTIVE OFFICERS

All being Management Committee Members

#### Timothy C. Melton

Executive Chairman

#### Ralph B. Young

President & Chief Executive Officer

#### Michael D. Shabada

Vice-President, Finance &  
Chief Financial Officer

#### W. Peter Daly

Vice-President,  
Community Development Division

#### Brett A. Halford

Vice-President, Administration

#### Brian Baker

Vice-President,  
Property Development Division

#### Darin Rayburn

Vice-President,  
Investment Property Division

### PROPERTY DEVELOPMENT DIVISION

900, 10310 Jasper Avenue  
Edmonton, Alberta T5J 1Y8  
(780) 423-6931

#### Brian Baker

Vice-President,  
Property Development Division

### INVESTMENT PROPERTY DIVISION

#### Commercial Property

900, 10310 Jasper Avenue  
Edmonton, Alberta T5J 1Y8  
(780) 423-6931

#### Darin Rayburn

Vice-President,  
Investment Property Division

#### Watergrove Manufactured Home Community

400, 99 Arbour Lake Road NW  
Calgary, Alberta T3G 4E4  
(403) 547-0200

#### Doug Alton

Manager

### FINANCE AND ADMINISTRATION

#### Karen Albarda

Operations Controller

#### Naomi Stefura

Corporate Controller

### COMMUNITY DEVELOPMENT DIVISION

#### Edmonton Region

900, 10310 Jasper Avenue  
Edmonton, Alberta T5J 1Y8  
(780) 423-6931

#### Jordan Davis

Regional Manager,  
Edmonton North

#### Chris Nicholas

Regional Manager,  
Edmonton South

#### Calgary Region

204, 400 Crowfoot Crescent N.W.  
Calgary, Alberta T3G 5H6  
(403) 283-3556

#### Dennis Inglis

Regional Manager

#### Red Deer Region

502 Parkland Square  
Red Deer, Alberta T4N 6M4  
(403) 343-0817

#### Guy Pelletier

Vice-President, Red Deer Region

### Lethbridge Region

1425-33 Street N., 2nd Floor  
Lethbridge, Alberta T1H 5H2  
(403) 328-0475

#### Neil Johnson

Vice-President, Lethbridge Region

### RECREATION PROPERTY DIVISION

#### The Links At Spruce Grove

P.O. Box 4268  
100 Links Road  
Spruce Grove, Alberta T7X 3B4  
(780) 962-4653

#### Pierre Beauchemin

Manager/Head Professional

#### Glen Andersen

Superintendent

#### Lewis Estates Golf Course

260 Suder Greens Drive  
Edmonton, Alberta  
(780) 489-1369

#### Jerry Linquist

Manager/Head Professional

#### Rob Sklaruk

Superintendent

#### Black Mountain Golf Course

575 Black Mountain Drive  
Kelowna, British Columbia V1P 1P7  
(250) 765-6890

#### Eric Thorsteinson

Manager/Head Professional

#### Barry Skabar

Superintendent

### KELOWNA REGION

207, 1664 Richter Street  
Kelowna, British Columbia V1Y 8N3  
(250) 717-8390

#### Brad Pelletier

Vice-President, Kelowna Region

### Notice of Annual Meeting

The annual meeting of Shareholders will be held at the University of Alberta, Business Building (Stollery Executive Development Centre), Room 504, 5th Floor, 11211 Saskatchewan Drive, Edmonton, Alberta, Canada on the 16th day of April, 2010 at 11:00 am MDT.

### Other Information

*Share Transfer Agent:*  
Valiant Trust Company, Edmonton

*Stock Exchange Listing:*  
The Toronto Stock Exchange (Stock symbol: MRD)

*Auditors:*  
PricewaterhouseCoopers LLP, Chartered Accountants,  
Edmonton

*Corporate Lawyers:*  
Field LLP, Calgary



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**For Immediate Release****Melcor Developments Ltd., (TSX:MRD) Reports Strong Second Quarter Results**

Melcor Developments Ltd., an Alberta-based real estate development Company, reported net earnings of \$10,138,000 or \$0.33 per share (basic) on revenue of \$66,017,000 for the six months ended June 30, 2010 compared to net earnings of \$3,929,000 or \$0.13 per share (basic) on revenue of \$43,362,000 for the same period in 2009.

Earnings for the three months ending June 30, 2010 were \$5,501,000 or \$0.18 per share (basic) on revenue of \$35,770,000 compared to earnings of \$3,746,000 or \$0.12 per share (basic) on revenue of \$27,279,000 during the same period in 2009.

Earnings are up for the quarter and year to date compared to 2009 due to improved real estate markets primarily in the Community Development Division. The Division experienced an increase in revenue of 82% over the same period in the prior year and an increase in profit margins which are returning to the long term historical levels for the division. The increase in revenue is due to an increase in housing demand, as confidence in the housing market has improved, combined with affordable interest rates. During the quarter, the Community Development Division purchased 3 land parcels comprising 24 acres net of joint venture interest in Edmonton, Alberta, 25 acres in Northwest Calgary, Alberta and 80 acres in the Phoenix area of Arizona, USA. The 25 acres in Calgary are part of the formation of a new joint venture that brings the company's holdings in that investment to 75 acres net of joint venture interests. Subsequent to the quarter, the division conditionally purchased 155 acres in West Edmonton with the view of finalizing the formation of a new joint venture with a third party. In addition, the Company approved the purchase of 360 acres (216 acres net of joint venture interest) in Cochrane, Alberta, which should generate revenue in 2011.

The Company's retail commercial and office portfolio continues to grow in size and profitability even with some downward pressure on occupancy and rental rates. In June, the Investment Property Division closed on the purchase of a 240 residential complex comprising 11.5 acres in metro Houston, Texas. The purchase price, including closing costs, was US\$20,632,000 and the mortgage assumption was US\$16,167,000. The property is expected to contribute to earnings for 2010.

Subsequent to the quarter, the Company refinanced and funded one of its larger office buildings for \$29,000,000 (\$20,520,000 net of previous mortgage payout) for a fixed term of 5 years at 4.77% and negotiated a 10 year fixed rate loan at 4.91% for \$8,200,000 (\$4,100,000 net of joint venture interest) with funding set for early August 2010, on a revenue property in Chestermere, Alberta.

The Company believes that the Alberta residential real estate markets have now stabilized and expects to see cautious growth continuing for the foreseeable future. While commercial real estate is going through a rebalancing, primarily in the office market, it is not expected to have a significant negative impact to the operations of the division. The Company remains confident that it has the appropriate assets, capital resources and experienced management team to continue to create value for the shareholders during the current real estate business cycle.

**For further information please contact the undersigned.**

**Business Contact**

Ralph B. Young, President & CEO  
info@melcor.ca  
Tel: (780) 423-6931

**Investor Relations**

Michael D. Shabada, C.A., V.P. Finance & CFO  
info@melcor.ca  
Tel: (780) 945-2819

**CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS**

	<i>For the six months ended</i>		<i>For the three months ended</i>	
	June 30,	June 30,	June 30,	June 30,
<b>Unaudited – (\$000's)</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Revenue	66,017	43,362	35,770	27,279
Cost of sales	(36,354)	(25,004)	(19,568)	(15,240)
	29,663	18,358	16,202	12,039
Interest income	1,061	1,053	590	638
Interest expense	(5,937)	(5,586)	(2,992)	(2,784)
General and administrative expenses	(6,125)	(4,995)	(3,427)	(2,689)
Amortization expense	(4,594)	(3,681)	(2,743)	(1,970)
Gain on sale of investment properties	7	358	7	19
Earnings before income taxes	14,075	5,507	7,637	5,253
Income tax expense	(3,937)	(1,578)	(2,136)	(1,507)
<b>Net earnings for the period</b>	<b>10,138</b>	<b>3,929</b>	<b>5,501</b>	<b>3,746</b>
Retained earnings, beginning of the period	314,457	298,754	319,094	298,937
Dividends paid	(4,551)	(2,978)	(4,551)	(2,978)
Retained earnings, end of the period	320,044	299,705	320,044	299,705
Basic earnings per share	.33	.13	.18	.12
Diluted earnings per share	.33	.13	.18	.12

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

	<i>For the six months ended</i>		<i>For the three months ended</i>	
	June 30,	June 30,	June 30,	June 30,
<b>Unaudited – (\$000's)</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Net earnings for the period	10,138	3,929	5,501	3,746
Other comprehensive income				
Unrealized gains (losses) on translation of financial statements of self sustaining foreign operation	(96)	(411)	175	(733)
Comprehensive income	10,042	3,518	5,676	3,013

**CONSOLIDATED STATEMENT OF ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

	<i>For the six months ended</i>		<i>For the three months ended</i>	
	June 30,	June 30,	June 30,	June 30,
<b>Unaudited – (\$000's)</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Balance, beginning of period	(1,512)	(230)	(1,783)	92
Other comprehensive income (loss)	(96)	(411)	175	(733)
Balance, end of period	(1,608)	(641)	(1,608)	(641)

## CONSOLIDATED BALANCE SHEET

(\$000s)	June 30, 2010	December 31, 2009
	(Unaudited)	(Audited)
<b>ASSETS</b>		
Cash and cash equivalents	5,182	3,947
Accounts receivable	9,185	10,306
Income taxes recoverable	-	1,450
Agreements receivable	59,930	81,316
Land inventory (Note 3)	430,392	413,667
Investment properties	201,960	180,123
Capital assets	418	439
Deferred costs and other assets	18,263	16,955
	<b>725,330</b>	<b>708,203</b>
<b>LIABILITIES</b>		
Bank operating loan	52,058	68,026
Accounts payable and accrued liabilities	19,274	17,707
Income taxes payable	922	-
Provision for land development costs	45,343	43,154
Debt on land inventory	70,443	65,556
Debt on investment properties	184,881	165,110
Future income taxes	19,930	22,130
	<b>392,851</b>	<b>381,683</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 2)	13,250	13,003
Contributed surplus	793	572
Retained earnings	320,044	314,457
Accumulated other comprehensive loss	(1,608)	(1,512)
	<b>332,479</b>	<b>326,520</b>
	<b>725,330</b>	<b>708,203</b>

# **CONSOLIDATED STATEMENT OF CASH FLOWS**

<b>Unaudited – (\$'000's)</b>	<b>For the six months ended</b>		<b>For the three months ended</b>	
	<b>June 30, 2010</b>	<b>June 30, 2009</b>	<b>June 30, 2010</b>	<b>June 30, 2009</b>
<b>CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES</b>				
Net earnings for the period	<b>10,138</b>	3,929	<b>5,501</b>	3,746
Non cash items:				
Amortization of investment properties	<b>2,919</b>	2,453	<b>1,777</b>	1,346
Amortization of tenant leasing costs	<b>1,615</b>	1,160	<b>936</b>	592
Amortization of capital assets	<b>60</b>	68	<b>30</b>	32
Stock based compensation expense	<b>221</b>	68	<b>110</b>	34
(Gain)/loss on sale of investment properties	<b>(7)</b>	(358)	<b>(7)</b>	(19)
Future income tax expense/(recovery)	<b>(2,200)</b>	(1,800)	<b>(1,600)</b>	(900)
	<b>12,746</b>	5,520	<b>6,747</b>	4,831
Agreements receivable	<b>21,386</b>	15,770	<b>15,356</b>	8,212
Development activities	<b>5,300</b>	513	<b>(617)</b>	69
Operating assets and liabilities	<b>2,201</b>	(9,272)	<b>7,850</b>	(241)
	<b>41,633</b>	12,531	<b>29,336</b>	12,871
<b>CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES</b>				
Purchase of land inventory	<b>(5,922)</b>	-	<b>(4,384)</b>	-
Proceeds from sale of investment properties	<b>10</b>	651	<b>10</b>	92
Investment property additions	<b>(7,708)</b>	(18,213)	<b>(6,371)</b>	(10,115)
Capital asset additions	<b>(39)</b>	(4)	<b>(24)</b>	(2)
	<b>(13,659)</b>	(17,566)	<b>(10,769)</b>	(10,025)
<b>CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES</b>				
Bank operating loan	<b>(15,999)</b>	11,648	<b>(15,947)</b>	3,538
Proceeds from land development financing	-	1,511	-	-
Repayment of debt on land inventory	<b>(9,027)</b>	(5,193)	<b>(4,972)</b>	(1,838)
Proceeds from investment property financing	<b>6,150</b>	2,720	<b>6,150</b>	800
Repayment of debt on investment properties	<b>(3,590)</b>	(1,914)	<b>(1,134)</b>	(972)
Dividends paid	<b>(4,551)</b>	(2,978)	<b>(4,551)</b>	(2,978)
Share capital issued	<b>247</b>	23	<b>232</b>	23
	<b>(26,770)</b>	5,817	<b>(20,222)</b>	(1,427)
<b>FOREIGN EXCHANGE GAIN/(LOSS) ON CASH HELD IN FOREIGN CURRENCY</b>	<b>31</b>	(128)	<b>123</b>	(385)
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS DURING THE PERIOD</b>	<b>1,235</b>	654	<b>(1,532)</b>	1,034
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD</b>	<b>3,947</b>	1,788	<b>6,714</b>	1,408
<b>CASH AND CASH EQUIVALENTS, END OF THE PERIOD</b>	<b>5,182</b>	2,442	<b>5,182</b>	2,442



## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

### 1. BASIS OF PRESENTATION

The accompanying unaudited interim financial statements, except as explained in Note 5, have been prepared by the Company, following the same accounting policies and methods as those disclosed in the audited financial statements for the year ended December 31, 2009. Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in Canada have been omitted. These interim financial statements should be read in conjunction with the December 31, 2009 audited financial statements and the notes thereto. In the opinion of management, all adjustments, which are of a normal and recurring nature, necessary for a fair presentation of the balance sheet, results of operations, and cash flows of these interim periods, have been included.

Earnings will fluctuate from one quarter to another due to the timing of plan registrations and the cyclical nature of the real estate markets.

### 2. SHARE CAPITAL

Issued and outstanding common shares at June 30, 2010 are 30,339,230 (December 31, 2009 – 30,283,730). There were 52,500 options exercised during the current quarter (6,000 during the second quarter in 2009), for a total of 55,500 year to date (6,000 year to date in the prior year).

### 3. LAND INVENTORY

(\$000s)	June 30, 2010 (Unaudited)	December 31, 2009 (Audited)
Undeveloped land and carrying costs	267,936	245,409
Pre development costs	56,160	54,701
Developed land inventory cost	106,296	113,557
	430,392	413,667

During the three months ended June 30, 2010, the Company purchased 129 acres of land (348 year to date) at a cost of \$9,727,000 (\$19,836,000 year to date) and received vendor financing of \$5,343,000 (\$13,914,000 year to date). During the same period in the prior year, the Company did not purchase any land.

Land inventory expensed to cost of sales during the quarter was \$13,817,000 (\$26,107,000 year to date). This compares to the same period in 2009 where \$10,333,000 was expensed to cost of sales (\$14,228,000 year to date).

#### **4. FINANCIAL GUARANTEES**

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In the normal course of operations, the Company issues letters of credit as security for the completion of obligations pursuant to development agreements signed with municipalities. At June 30, 2010 the Company had \$30,086,000 (December 31, 2009 - \$30,437,000) in letters of credit outstanding. A substantial portion of the costs for which the letters of credit have been provided as security, have been recorded in the provision for land development costs in respect of these development agreements.

Normally, obligations, along with letters of credit securing such obligations, diminish as the developments proceed, through a series of staged reductions over a period of years (average of three to four) and are ultimately extinguished when the municipality has issued final completion certificates.

The Company enters into joint venture agreements and, in doing so, may take on risk beyond its proportionate interest in the joint venture. These situations generally arise where preferred financing terms can be arranged on the condition that the strength of the Company's covenant will backstop that of the other joint venture participant(s) who also provide similar guarantees. The Company will have to perform on its guarantee only if a joint venture participant was in default of their guarantee. At June 30, 2010 the Company had guaranteed \$2,773,000 (December 31, 2009 - \$6,268,000) in loans and \$5,941,000 (December 31, 2009 - \$6,597,000) in letters of credit in support of other participant's interests. The loan guarantees include those which are ongoing, as they relate to the relevant lines of credit, and those which have staged reductions as they relate to the financing of specific assets or projects such as infrastructure loans, short-term land loans or mortgages.

To mitigate the possibility of financial loss, Melcor is diligent in its selection of joint venture participants. As well, Melcor has various remedies available to it within the joint venture agreement.

#### **5. CHANGES IN ACCOUNTING POLICIES**

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Effective January 1, 2010 the Company adopted CICA Handbook Section 1582 - *Business Combinations*, which applies prospectively for business combinations for which the acquisition date is on or after January 1, 2010. The standard requires use of the acquisition method which results in, among other things, all assets and obligations of an acquired business recorded at fair value at acquisition, and all transaction costs associated with the acquisition recorded as expenses as incurred.

As a result of the adoption of Section 1582, the Company also adopted CICA Handbook Sections 1601 - *Consolidations* and 1602 - *Non-Controlling Interests* effective January 1, 2010. All three sections must be adopted concurrently. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The adoption of Sections 1601 and 1602 did not impact the Company's financial statements.

## 6. SEGMENTED INFORMATION

A summary of the Company's wholly owned subsidiary, with operations in the United States, are as follows:

	<i>For the six months ended</i>		<i>For the three months ended</i>	
<b>(\$000s)</b>	<b>June 30, 2010</b>	June 30, 2009	<b>June 30, 2010</b>	June 30, 2009
External revenue	<b>477</b>	8	<b>355</b>	-
Gain/(Loss)	<b>12</b>	(217)	<b>19</b>	(192)
Interest Income	-	-	-	-
Interest Expense	<b>84</b>	-	<b>84</b>	-
Assets	<b>31,317</b>	8,679	<b>31,317</b>	8,679
Equity	<b>8,140</b>	8,656	<b>8,140</b>	8,656

On June 1, 2010, the Company acquired a 240 unit residential complex near Houston, Texas, which has been accounted for using the acquisition method. The acquisition resulted in an increase to investment properties of \$21,965,000 (US\$ 20,632,000) and was financed with the assumption of a mortgage in the amount of \$17,211,000 (US\$ 16,167,000), with the remainder being a cash outlay to the Company.

The amounts of revenue and net income of the acquiree since the acquisition date included in the consolidated statement of comprehensive income for the reporting period are \$222,000 and \$14,000 respectively.

The Company is unable to present pro forma revenue and earnings as though the acquisition date had been January 1, 2010, as the information necessary to determine these amounts is not available to the Company.

## 6. SEGMENTED INFORMATION (continued)

The business units of the Company report the following activities:

For the six months ended June 30, 2010				For the six months ended June 30, 2009			
(\$000's) REVENUE	Segment Revenue	Inter- segment Eliminations	External Revenue	Segment Revenue	Inter- segment Eliminations	External Revenue	
Community development	41,886	(28)	<b>41,858</b>	22,969	(25)	22,944	
Property development	7,055	(7,050)	<b>5</b>	31,268	(31,210)	58	
Investment property	21,817	(476)	<b>21,341</b>	18,631	(485)	18,146	
Recreation property	2,835	(22)	<b>2,813</b>	2,242	(28)	2,214	
	<u>73,593</u>	<u>(7,576)</u>	<u><b>66,017</b></u>	<u>75,110</u>	<u>(31,748)</u>	<u>43,362</u>	
(\$000's) EARNINGS	Segment Earnings	Inter- segment Eliminations	External Earnings	Segment Earnings	Inter- segment Eliminations	External Earnings	
Community development	14,132	-	<b>14,132</b>	5,663	-	5,663	
Property development	1,463	(1,855)	<b>(392)</b>	10,157	(10,487)	(330)	
Investment property	4,099	-	<b>4,099</b>	3,788	-	3,788	
Recreation property	(268)	-	<b>(268)</b>	(409)	-	(409)	
	<u>19,426</u>	<u>(1,855)</u>	<u><b>17,571</b></u>	<u>19,199</u>	<u>(10,487)</u>	<u>8,712</u>	
<b>Non-allocated items:</b>							
Interest income			<b>75</b>			77	
Interest expense			<b>(1,030)</b>			(1,383)	
General and administrative expenses			<b>(2,541)</b>			(1,899)	
Earnings before income tax expense			<b>14,075</b>			5,507	
Income tax expense			<b>(3,937)</b>			(1,578)	
<b>Net earnings for the period</b>			<u><b>10,138</b></u>			<u>3,929</u>	
(\$000's) INTEREST	Per Segment	Inter- segment Eliminations	Per Financial Statement	Per Segment	Inter- segment Eliminations	Per Financial Statement	
<b>Interest Income:</b>							
Community development	967	-	<b>967</b>	965	-	965	
Property development	-	-	<b>-</b>	-	-	-	
Investment property	19	-	<b>19</b>	11	-	11	
Recreation property	-	-	<b>-</b>	-	-	-	
Non-allocated	75	-	<b>75</b>	77	-	77	
	<u>1,061</u>	<u>-</u>	<u><b>1,061</b></u>	<u>1,053</u>	<u>-</u>	<u>1,053</u>	
<b>Interest Expense:</b>							
Community development	(307)	-	<b>(307)</b>	(437)	-	(437)	
Property development	-	-	<b>-</b>	-	-	-	
Investment property	(4,482)	-	<b>(4,482)</b>	(3,648)	-	(3,648)	
Recreation property	(118)	-	<b>(118)</b>	(118)	-	(118)	
Non-allocated	(1,030)	-	<b>(1,030)</b>	(1,383)	-	(1,383)	
	<u>(5,937)</u>	<u>-</u>	<u><b>(5,937)</b></u>	<u>(5,586)</u>	<u>-</u>	<u>(5,586)</u>	



6. **SEGMENTED INFORMATION (continued)**

(\$000's)	For the three months ended June 30, 2010			For the three months ended June 30, 2009		
	Segment Revenue	Inter- segment Eliminations	External Revenue	Segment Revenue	Inter- segment Eliminations	External Revenue
<b>REVENUE</b>						
Community development	22,129	(28)	<b>22,101</b>	16,001	(25)	15,976
Property development	2,952	(2,950)	<b>2</b>	31,250	(31,210)	40
Investment property	11,157	(238)	<b>10,919</b>	9,303	(242)	9,061
Recreation property	2,766	(18)	<b>2,748</b>	2,219	(17)	2,202
	<u>39,004</u>	<u>(3,234)</u>	<b>35,770</b>	<u>58,773</u>	<u>(31,494)</u>	<u>27,279</u>
(\$000's)	Segment Earnings	Inter- segment Eliminations	External Earnings	Segment Earnings	Inter- segment Eliminations	External Earnings
<b>EARNINGS</b>						
Community development	7,403	-	<b>7,403</b>	4,976	-	4,976
Property development	850	(1,055)	<b>(205)</b>	10,291	(10,487)	(196)
Investment property	1,758	-	<b>1,758</b>	1,835	-	1,835
Recreation property	444	-	<b>444</b>	228	-	228
	<u>10,455</u>	<u>(1,055)</u>	<b>9,400</b>	<u>17,330</u>	<u>(10,487)</u>	<u>6,843</u>
<b>Non-allocated items:</b>						
Interest income			<b>75</b>			15
Interest expense			<b>(491)</b>			(712)
General and administrative expenses			<b>(1,347)</b>			(893)
Earnings before income tax expense			<b>7,637</b>			5,253
Income tax expense			<b>(2,136)</b>			(1,507)
<b>Net earnings for the period</b>			<b>5,501</b>			<u>3,746</u>
(\$000's)	Per Segment	Inter- segment Eliminations	Per Financial Statement	Per Segment	Inter- segment Eliminations	Per Financial Statement
<b>INTEREST</b>						
<b>Interest Income:</b>						
Community development	500	-	<b>500</b>	619	-	619
Property development	-	-	<b>-</b>	-	-	-
Investment property	15	-	<b>15</b>	4	-	4
Recreation property	-	-	<b>-</b>	-	-	-
Non-allocated	75	-	<b>75</b>	15	-	15
	<u>590</u>	<u>-</u>	<b>590</b>	<u>638</u>	<u>-</u>	<u>638</u>
<b>Interest Expense:</b>						
Community development	(146)	-	<b>(146)</b>	(217)	-	(217)
Property development	-	-	<b>-</b>	-	-	-
Investment property	(2,286)	-	<b>(2,286)</b>	(1,796)	-	(1,796)
Recreation property	(69)	-	<b>(69)</b>	(59)	-	(59)
Non-allocated	(491)	-	<b>(491)</b>	(712)	-	(712)
	<u>(2,992)</u>	<u>-</u>	<b>(2,992)</b>	<u>(2,784)</u>	<u>-</u>	<u>(2,784)</u>

# MELCOR DEVELOPMENTS LTD.

## MANAGEMENT'S DISCUSSION AND ANALYSIS ("MD&A") JULY 29, 2010

The following discussion and analysis of the interim operating results and financial position of Melcor Developments Ltd. as at June 30, 2010 should be read in conjunction with the unaudited interim financial statements for the six months ended June 30, 2010 and the audited financial statements and notes to those statements for the years ended December 31, 2009 and 2008 and the 2009 annual MD&A. Certain statements in this discussion can be considered forward looking, and readers are cautioned that such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those contained in these forward looking statements. These risks and uncertainties are described elsewhere in this discussion and in other regulatory filings.

The balance sheet is presented without reference to current assets or current liabilities. The operating cycle of an entity involved in real estate investment and development is normally considered to be longer than one year. Thus, the concept of current assets and current liabilities is not considered relevant and there is no need to segregate the balance sheet to disclose assets or liabilities which are expected to be settled within the immediately following year.

### DIVISIONAL ACTIVITIES

#### A. COMMUNITY DEVELOPMENT OPERATIONS

Operating Review (\$000)	Six Months ended June 30th		Three Months ended June 30th	
	2010	2009	2010	2009
Revenue	41,886	22,969	22,129	16,001
Cost of sales	(26,107)	(14,228)	(13,817)	(10,333)
Allowance adjustments	-	(760)	-	-
Option deposit forfeited	-	(709)	-	-
	15,779	7,272	8,312	5,668
Interest revenue	967	965	500	619
Interest expense	(307)	(437)	(146)	(217)
	16,439	7,800	8,666	6,070
Administrative expenses	(2,307)	(2,137)	(1,263)	(1,094)
Divisional earnings	14,132	5,663	7,403	4,976

Six months ended June 30, 2010				Six months ended June 30, 2009		
Revenue analysis (\$)	(1) External Revenue	(2) Units/Acres @ 100 %	(3) Gross Average Revenue Per Unit/Acre	(1) External Revenue	(2) Units/Acres @ 100 %	(3) Gross Average Revenue Per Unit/Acre
Single family lots	36,835,000	336	139,200	22,461,000	246	118,700
Multiple family lots	3,511,000	6.0	674,100	-	-	-
Commercial	-	-	-	-	-	-
Industrial	820,000	6.1	270,200	-	-	-
Non-strategic parcels	48,000	0.2	220,800	68,000	1.1	68,000
Other land	-	-	-	-	-	-
Management fees & other	644,000	-	-	415,000	-	-
	41,858,000			22,944,000		

(1) External Revenue excludes inter-divisional sales. (See Segmented Information note to Consolidated Interim Financial Statements).

(2) Units/Acres are not prorated for joint venture interests.

(3) Gross average revenue per unit/acre is based on the inclusion of the joint venture participant's interests in both revenue and in the unit/acres sold.

Six months ended June 30, 2010						
Regional sales analysis	Single Family Lots	Gross Average Revenue Per Unit	(Acres)			
			Multi-Family	Commercial	Industrial	Raw Land
Edmonton	242	141,200	6.0	-	-	0.2
Calgary	41	149,800	-	-	-	-
Red Deer	7	150,700	-	-	6.1	-
Lethbridge	38	97,600	-	-	-	-
Kelowna	8	213,500	-	-	-	-
	336	139,200	6.0	-	6.1	0.2

Six months ended June 30, 2009						
Regional sales analysis	Single Family Lots	Gross Average Revenue Per Unit	(Acres)			
			Multi-Family	Commercial	Industrial	Raw Land
Edmonton	149	131,900	-	-	-	-
Calgary	29	111,500	-	-	-	-
Red Deer	47	96,100	-	-	-	1.1
Lethbridge	19	68,000	-	-	-	-
Kelowna	2	249,500	-	-	-	-
	246	118,700	-	-	-	1.1

Residential Lot Sale Inventory (including joint ventures at 100%)	Six Months ended June 30th		Three Months ended June 30th	
	2010	2009	2010	2009
Opening Balance	561	1,112	460	1,034
New Developments	195	5	129	5
Sales	(336)	(246)	(169)	(168)
Ending Balance	420	871	420	871

Multi-Family/Commercial/Industrial Site Inventory (including joint ventures at 100%)	Six Months ended June 30th		Three Months ended June 30th	
	2010	2009	2010	2009
Opening Balance	164	161	171	166
New Developments	38	9	28	4
External Sales	(13)	-	(10)	-
Internal Transfers	-	-	-	-
Ending Balance	189	170	189	170

Revenues in the second quarter of 2010 showed a significant increase over the comparable period in 2009. Edmonton as a region has continued to see the strongest sales in the current year as compared with other regions. Sales volumes and margins are in line with management's expectations in all regions.

Inventory levels remain satisfactory in comparison to this time last year when excess inventory was one of the Division's major concerns. The Division has ended all discount programs and is working to re-establish higher margins to be more consistent with historical averages. The Division has plans in place for the creation of new lot inventory in areas of high demand.

Development has commenced in northwest Calgary in the Valley Ridge area of the city. The project has been met with much enthusiasm and marks the Company's first development within the city of Calgary since 2002. The Division expects to sell a significant portion of these lots in the second half of the current year, pending plan registrations.



Shareholders are reminded that earnings can fluctuate significantly from one year to another due to the timing of plan registrations, the cyclical nature of real estate markets, the mix of lot sizes and product types, and the mix of joint venture sales activity.

During the quarter, the division purchased 3 parcels of land comprising 24 acres (net of joint venture interest) in Edmonton, Alberta, 25 acres in northwest Calgary, Alberta and 80 acres in the Phoenix area of Arizona, USA.

The 25 acres in Calgary are part of the formation of a new joint venture that brings the company's holdings in that investment to 75 acres (net of joint venture interests). The Division anticipates that development of these lands could begin as early as 2011.

Subsequent to the quarter, the division conditionally purchased 155 acres in west Edmonton with the view of finalizing the formation of a new joint venture with a third party. In addition, the Company approved the purchase of 360 acres (216 acres net of joint venture interest) in Cochrane, Alberta which should generate revenue in 2011.

The Company continues to investigate real estate property acquisitions throughout Alberta, Saskatchewan, British Columbia and in the United States.

## B. PROPERTY DEVELOPMENT OPERATIONS

Operating Review (\$000)	Six Months ended June 30th		Three Months ended June 30th	
	2010	2009	2010	2009
Revenue	7,055	31,268	2,952	31,250
Cost of sales	(5,194)	(20,723)	(1,894)	(20,723)
Net operating income	1,861	10,545	1,058	10,527
Administrative expenses	(398)	(388)	(208)	(236)
Divisional earnings	1,463	10,157	850	10,291

A 6,000 sq. ft. Commercial Rental Unit ("CRU") building was transferred to the Investment Properties Division during the current quarter at a transfer price of \$2,950,000 for an intersegment gain of \$1,055,000 to the Division. This transfer marks the completion of Leduc Common Phase 1.

### Leduc Common

Active interest remains for this site. The Division plans to commence construction of an additional CRU building in Leduc Common Phase 3. The remaining development of Leduc Common will be completed within the next five years.

### Miller Commercial

Construction of two CRU buildings commenced in the current quarter with anticipated available space for tenant possession next year. The addition of the two CRU buildings will complete this 3.3 acre development located in Edmonton's northeast.

### Westgrove Common

This development, located in Spruce Grove, continues to grow. The construction of a bank site is completed with transfer to Investment Properties to occur in the third quarter. Future development of 23,000 sq. ft. of retail space will complete the current phase. Additional commercial sites adjacent to the Westgrove Common could be developed in 2 to 5 years.

### Chestermere Station

Activity in Chestermere Station remains strong. During the second quarter, the Division commenced construction on two of three proposed separate buildings, totaling just over 10,000 sq. ft. of retail space once all three have been completed. The Division also has a development permit to construct a 53,000 sq. ft. professional building. Construction is pending leasing activity.



## Kingsview Market

The Division has initiated construction at the Kingsview Market, a 38 acre development in Airdrie. Phase one will include the construction of three buildings totaling approximately 40,000 sq. ft. Leasing interest has been very strong.

## Other Projects

Currently the division is engaged in obtaining planning approvals, design and pre-leasing of a number of projects in multiple regions including Red Deer, Airdrie, Lethbridge, Calgary, and South Edmonton and West Edmonton.

## C. INVESTMENT PROPERTY OPERATIONS

Operating Review (\$000)	Six Months ended June 30th		Three Months ended June 30th	
	2010	2009	2010	2009
Rental revenue	21,817	18,631	11,157	9,303
Operating expenses	(8,864)	(8,039)	(4,622)	(3,907)
Net operating income	12,953	10,592	6,535	5,396
Interest income	19	11	15	4
Interest expense	(4,482)	(3,648)	(2,286)	(1,796)
Amortization of investment properties	(2,328)	(1,960)	(1,329)	(998)
Amortization of tenant leasing costs	(1,615)	(1,160)	(936)	(592)
Administrative expenses	(448)	(386)	(241)	(179)
Earnings from operations	4,099	3,449	1,758	1,835
Gain on sale of investment property	-	339	-	-
Divisional earnings	4,099	3,788	1,758	1,835

The Investment Property Division recorded earnings from operations of \$4,099,000 during the first six months of 2010 compared to \$3,449,000 during the same period in 2009. Net operating income (NOI) as a percentage of revenue for the year to date (59.4%) is up in comparison to the same period in 2009 (56.9%).

Comparison of same asset NOI from portfolio assets held during both periods year to date is \$11,384,000 for the first six months of 2010 which compares to \$10,538,000 during the same period in 2009 - an increase of 8.0% or \$846,000. Comparison of same asset NOI from portfolio assets held during the same quarter is \$5,749,000 for the second quarter of 2010 which compares to \$5,301,000 during the second quarter 2009 - an increase of 8.5% or \$448,000. NOI growth from portfolio assets is expected to continue to increase over the next few years as the portfolio continues to have existing leases which are expected to renew at higher rates.

Rental rates have remained stable during the second quarter of 2010. Occupancy is at 91% as at June 30, 2010, consistent with the prior quarter.

During the quarter, the Division acquired a 6,000 sq. ft. CRU building in Leduc Common, transferred from the Property Development Division (*as described in section B - "Property Development Operations"*).

On June 1, 2010 the Division closed on the purchase of a 240 unit residential complex comprising 11.5 acres near Houston, Texas, at a purchase price (including acquisition costs) of \$US 20,632,000, and assumed a \$US 16,167,000 mortgage. The Division continues to pursue other opportunities in the United States.

## D. RECREATIONAL PROPERTY OPERATIONS

Operating Review (\$000)	Six Months ended June 30th		Three Months ended June 30th	
	2010	2009	2010	2009
Revenue	2,835	2,242	2,766	2,219
Operating expenses	(1,430)	(1,314)	(1,172)	(1,039)
	1,405	928	1,594	1,180
Interest expense	(118)	(118)	(69)	(59)
Administrative expenses	(971)	(745)	(640)	(564)
Depreciation expense	(591)	(493)	(448)	(348)
Earnings (loss) from operations	(275)	(428)	437	209
Gain on sale of assets	7	19	7	19
Divisional earnings (loss)	(268)	(409)	444	228

This Division owns and manages three 18-hole championship golf courses, two that are in the Edmonton region (one of which is 60% owned), and one in the Black Mountain region of Kelowna, British Columbia. In addition, the Division owns a 50% interest in another golf course in south west Edmonton.

The Kelowna golf course was fully operational throughout the second quarter, leading to increased revenues as compared to this time last year, given that the course only opened to the public in June 2009.

## LIQUIDITY AND CAPITAL RESOURCES

The US sub-prime lending debacle, that sent global financial markets into a crisis, continues to impact liquidity for many enterprises. The Company's liquidity has been affected in several ways, both negatively and positively. Real estate, by its nature, is more liquid in good markets and less liquid in poor markets. In the current real estate market, our real estate is clearly less liquid in the short term, but current economics still support the fundamental value of the Company's real estate assets.

The Company uses two sources of funding to finance operations depending on the division:

- The Community Development Division uses a bank line of credit which margins the land development assets of the Company. These credit lines are used to fund the operations of the Company. Due to recent reductions in the prime borrowing rates, this Division has benefited by being able to borrow at rates fluctuating with prime. Even with an increase in the spread over prime, the cost of borrowing on a floating basis is currently lower compared to historical cost of funds. We had experienced some borrowing pressure as the repayment terms for certain of our agreements receivable were extended, which negatively impacted our margining ability. Our builders were able to move their inventory and our overdue agreements receivable are at normal levels. We continue to work with our main lender to modify the terms of our credit facility to better reflect our borrowing requirements.
- The Investment Property Division uses fixed rate, long term mortgage financing on its revenue producing assets to raise capital. Financing terms had tightened in 2009 as many lenders curtailed lending activity. This was compounded by the loss of the asset backed lending market. The tightening of terms included the reduction of loan amortization (from 25 years to 20 years), lower loan to value ratios (from 75% to 60%), tighter restrictions on debt coverage, increased pricing of loans as premium spreads have increased (from 125 basis points to 330 basis points) and a movement away from non-recourse loans. The effect to the Company has not been significant, given that the market value of the investment property assets have risen as a result of increased rental revenues. As such, the Company is still able to finance increased loan amounts from its existing portfolio of buildings. The Company continues to see a greater appetite from traditional lenders to lend with terms that continue to be more competitive with each passing month. Also, more and more lenders who left the mortgage market a year ago are now back lending money, adding to the number of choices available to borrowers. In



those situations where the Company provides a limited recourse on the loan, amortizations are back to 25 years, spreads are in the 170 – 210 basis point range over the benchmark Canada bond yield and loan to value ratios have risen to 65-70% range with some as high as 75%.

## **OFF-BALANCE SHEET ARRANGEMENTS CRITICAL ACCOUNTING ESTIMATES FINANCIAL INSTRUMENTS RECENT ACCOUNTING PRONOUNCEMENTS ISSUED BUT NOT YET ADOPTED**

There are no material changes to the above titled sections at June 30, 2010 in comparison to the December 31, 2009 annual MD&A.

## **DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING**

The President and Chief Executive Officer and the Vice President, Finance and Chief Financial Officer have evaluated whether there were material changes to internal control over financial reporting during the quarter ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting. No such changes were identified.

## **CHANGE IN ACCOUNTING POLICY**

### **International Financial Reporting Standards**

In February 2008, the AcSB confirmed that IFRS will be mandatory in Canada for profit-oriented publicly accountable entities for fiscal periods beginning on or after January 1, 2011. Our first annual IFRS financial statements will be for the year ending December 31, 2011 and will include the comparative period of 2010. Starting in the first quarter of 2011, we will provide unaudited consolidated interim financial information in accordance with IFRS including comparative figures for 2010.

The Company commenced its IFRS conversion project in 2008. A formal project plan and a project team, including an external advisor, have been established. Regular reporting is provided to senior management, the Audit Committee and the Board of Directors. The conversion plan consists of the following phases:

**Diagnostic phase** – This phase includes a high-level impact assessment of the differences between current Canadian GAAP and IFRS, focusing on the areas which will have the most significant impact to the Company. A preliminary conversion roadmap has been prepared as part of this phase.

**Design, planning and solution phase** – This phase focuses on determining the specific impact on the Company based on the application of the IFRS requirements. Accounting policies will be finalized, first-time adoption exemptions will be considered, draft financial statements and disclosures will be prepared and a detailed implementation plan and timeline will be developed. This phase also includes the development of a training plan.

**Implementation and review phase** – This phase includes execution of changes to accounting policies and practices, and implementation and testing of business processes, systems and internal controls. It also includes training programs for the company finance and other staff, as necessary.

The Company completed the diagnostic assessment phase in 2008 by performing comparisons of the differences between Canadian GAAP and IFRS. This assessment provided insight on the high risk and complex areas relating to the conversion. The Company determined that the most significant impact of IFRS conversion is to Investment Properties, the effects of which are elaborated on below.



The Company is now nearing the end of the design, planning and implementation phase. The Company's preliminary IFRS policies and procedures are in the process of being finalized. While new procedures and controls are being put into place to address certain unique IFRS accounting and disclosure requirements, the Company does not anticipate any significant comprehensive changes to its current accounting and consolidation systems, its internal controls or its disclosure control process as a result of the conversion to IFRS. Appropriate resources have been secured to complete the changeover on a timely basis. We have detailed project plans and progress reporting in place to support and communicate the changeover.

The following paragraphs describe the material changes between the Company's current Canadian GAAP accounting policies, and the anticipated accounting policy choices under IFRS. Certain accounting policies expected to be adopted under IFRS may not be adopted and the application of such policies to certain transactions or circumstances may be modified and, as a result, the impact of the conversion has not been quantified at this time.

### **IFRS 1: First-Time Adoption of IFRS**

The company's adoption of IFRS will require the application of IFRS 1, *First-time Adoption of International Financial Reporting Standards* ("IFRS1"), which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires that an entity apply all IFRS effective at the end of its first IFRS reporting period retrospectively. However, IFRS 1 does require certain mandatory exceptions and permits limited optional exemptions. The following are the optional exemptions available under IFRS 1 which are significant to the Company and which the Company expects to be applied in preparation of its first financial statements under IFRS:

#### *a) Business combinations*

IFRS 1 states that a first-time adopter may elect not to apply IFRS 3, *Business Combination* retrospectively to business combinations that occurred before the date of transition to IFRS. The Company intends to make this election in order to only apply IFRS 3 to business combinations prospectively (i.e. to those that occur on or after January 1, 2010).

#### *b) Cumulative translation differences*

International Accounting Standards ("IAS") 21, *The Effects of Changes in Foreign Exchange Rates*, requires an entity to determine the translation differences in accordance with IFRS from the date on which a subsidiary was formed or acquired. IFRS allows cumulative translation differences for all foreign operations to be deemed zero at the date of transition to IFRS, with future gains or losses on subsequent disposal of any foreign operations to exclude translation differences arising from periods prior to the date of transition to IFRS. The Company expects to deem all cumulative translation differences to be zero on transition to IFRS.

#### *c) Borrowing costs*

IAS 23, *Borrowing Costs*, requires an entity to capitalize the borrowing costs related to all qualifying assets. IFRS1 allows an entity to apply the requirements related to borrowing costs to qualifying assets for which the commencement date for capitalization is on or after its transition date or an earlier designated date. The Company elected to apply IAS 23 prospectively from its transition date (i.e. January 1, 2010).

#### *d) Share-based payment transactions*

On first time adoption of IFRS the requirements of IFRS 2, *Share-based Payment*, apply to all grants of equity settled transactions made after November 7, 2002 that have not yet vested at the transition date. A company may also choose to apply to any equity instruments that were granted before November 7, 2002, or that were granted after that date, and vested before the date of transition, but only if the company has previously disclosed the fair value of the instrument, determined at the measurement date. The Company has elected to apply IFRS 2 to all share-based payments that had not yet vested at the transition date



IFRS 1 allows for certain other optional exemptions; however, the company does not expect such exemptions to be significant to its adoption of IFRS.

### **Investment properties**

The Company considers its commercial properties, properties under development and manufactured home community to be investment properties under IAS 40, *Investment Property* ("IAS 40"). Investment properties include land and buildings held primarily to earn rental income or for capital appreciation or both, rather than for use in the production or supply of goods or for sale in the ordinary course of business. The Company notes that its golf course assets are not considered investment properties under IAS 40 and as such, will be accounted for as property, plant, and equipment. Similar to Canadian GAAP, investment properties are initially recorded at cost under IAS 40. However, subsequent to initial recognition, IFRS requires that an entity choose either the cost or fair value model to account for its investment properties. The company expects to use the fair value model when preparing its financial statements under IFRS. This will have a material impact on the Company's balance sheet given that the majority of the Company's investment properties have a fair value significantly higher than their current amortized cost.

The adoption of the fair value model will also have a significant impact on the Company's income statement. Under the fair value model, gains or losses arising from a change in the fair value of investment properties are to be recognized in income in the period of the change. Net income during any given period may be greater or less than as determined under Canadian GAAP depending on whether an increase or decrease in fair value occurs during the period of measurement. Under the fair value model, depreciation of investment properties is not recorded.

### **Other areas of change**

The conversion to IFRS will also have an impact on the Company's accounting for certain other areas such as borrowing costs, provisions, interests in joint ventures and tenant leasing costs.

All changes as described above will impact the accounting of deferred income taxes, most significantly related to the changes in the carrying values of the Company's investment properties.

Several IFRS standards are in the process of being amended by the IASB. Amendments to existing standards are expected to continue until the transition date of January 1, 2011. The Company is monitoring the IASB's active projects and all changes to IFRS will be incorporated as required.

At the current stage of the project, Melcor cannot reasonably determine the full impact that adopting IFRS would have on its financial position and future results.

## **SUMMARY OF QUARTERLY RESULTS**

Financial information for the prior eight fiscal quarters are as follows:

	(\$000s)	(\$000s)	Earnings Per Common Share	
	Revenues	Net Earnings	Basic	Diluted
June 30, 2008	19,779	3,702	.12	.12
September 30, 2008	25,967	18,542	.59	.58
December 30, 2008	41,758	14,404	.47	.47
March 31, 2009	16,083	183	.01	.01
June 30, 2009	27,279	3,746	.12	.12
September 30, 2009	44,374	9,377	.32	.31
December 31, 2009	48,872	9,918	.33	.33
March 31, 2010	30,247	4,637	.15	.15
June 30, 2010	35,770	5,501	.18	.18

